Examining Regulation of Electric Utilities

in the Face of Change

in the Electric Industry

Docket No. UE-940932

Reference Volume 2: Second Phase Written Comments

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Docket #UE-940932

Written Comments:

Attorney General: Public Counsel

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April 26, 1995

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Re: Electric Industry NOI
Docket No. UE-940932

Dear Mr. McLellan:

Enclosed are the Reply Comments of Public Counsel. We have enclosed ten copies and a diskette formatted in Wordperfect 5.1.

Very truly yours,

Robert F. Manifold
Assistant Attorney General
Public Counsel

RFM/ljb
Enclosures

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

Examining Regulation of Electric Utilities in the Face of Change in the Electric Industry	DOCKET NO. UE-940932 REPLY COMMENTS OF PUBLIC COUNSEL

Given the comprehensive opening comments filed by Public Counsel, our reply is purposely brief.

I. General Reactions to the Comments

A. In considering the future of regulation of the electric industry, the Commission's consideration of policy changes should be based on facts and analysis, not anecdotes and assertions.

The primary purpose of the NOI is to discuss changes that have occurred in the industry and their implications for regulation. Logically, this approach assumes a two step process: **1) to identify** and quantify the actual changes and **2) to assess** their implications for utilities and regulation.[1] It is only from a factual analysis that the true implications of any industry changes can be accurately assessed and addressed by the Commission.

After reviewing the comments, Public Counsel is concerned that many parties merely assert that the wholesale market (and the retail market, in the view of PacifiCorp) either is or is not competitive. No presentation of meaningful supporting evidence is provided.[2]

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[1] There is no question that the industry is quite dynamic and there are many possible futures that also can and should be considered; however, it seems most appropriate to first examine changes that have occurred and their implications before speculating as to the future. Puget makes the observation that it is important to recognize the distinction between industry developments that have occurred and may require regulatory revision, and potential industry changes. (Puget Power and Light Company, First Round Comments in p. 2.)

[2] For example, PacifiCorp presents a long list of events that supposedly demonstrate "competition". (PacifiCorp, Opening Comments in Docket UE-940932, p. 1-2.) First, a company's

Parties claiming the wholesale market is competitive (however they have defined the wholesale market -- which is often unclear) give little attention to the implications for regulation, if, indeed, there are any.[3]

Public Counsel indicated in opening comments that the dual role of utilities as buyer and seller in the wholesale market may cause distortions and therefore fail to capture all market efficiencies. Accordingly, we suggested this factor be considered in the evaluation of that market, along with other issues, and offered a framework for such an analysis.[4]

B. No one has made a persuasive case for retail wheeling based on increased opportunities for *economic* bypass. There has been no showing that there would be specific net benefits for all customers.

With little or no supporting evidence, several parties attempted to justify open or mandatory retail access on the basis that industrial customers face new opportunities for economic power alternatives. On the other hand, the Northwest Power Planning Council presented analysis, supported by actual

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announcement of its intent to provide energy services in a different service area is not the same as a finding of effective competition. The type of "evidence" proferred by PacifiCorp would easily fail the standards enunciated for effective competition for telecommunications companies per RCW 80.36.320 and .330. Second, many of the "examples of competition" are from out of state and out the Northwest region. While developments outside of Washington may be interesting and worthy of examination, the specific characteristics of the Washington market should be the focus. Third, PacifiCorp neither distinguishes between the wholesale and retail markets nor addresses the implications of remaining monopoly bottlenecks in transmission and distribution held by vertically integrated utilities.

[3] In the NOI, the Commission posed an important question regarding wholesale competition and its relation to other aspects of the industry: *Is the existence of a vital and competitive wholesale power market, and full utilization of this market by utilities sufficient to capture the full measure of benefits from competition in the electric industry? If not, should the Commission take actions to facilitate competition in retail service?* Very few parties answered this question directly, yet the answer to this question is the crux of the restructuring debate. One's response reveals many assumptions regarding the underlying economics of the industry. This issue should be the focus of a workshop.

[4] Public Counsel, Opening Comments, p. 9-11.

evidence, demonstrating that opportunities for economic bypass may actually be quite limited.[5] The Commission must assess the economic viability of bypass. If it is demonstrated that the threat is real and growing, then an estimation of the percentage of "at risk load" can be calculated. With a factual foundation, the Commission can determine if that load should be retained, and, if so, evaluate alternatives, including pricing flexibility to facilitate retention of customers where justified.

Even if it is found that significant industrial load is at risk due to new economic bypass opportunities, there are substantial issues of equity and economic fairness regarding the design of a retail access framework. We should not assume the need exists, and then embark on an analysis of the contentious and complex issues of the establishment of terms, conditions, and pricing for retail access and unbundled energy services; the quantification and resolution of potentially stranded investment; and the modification of the obligation to serve. It first needs to be determined whether a dramatic restructuring is needed.

C. Revision of the Commission's regulatory processes should begin with identification of any weaknesses, and then determine how other techniques might address those weaknesses, while still serving public interest goals and principles.

The Commission's regulatory processes can be improved and streamlined, but any effort to revise regulatory approaches should begin with identification of the problems with the current methods. We do not generally find fault with regulatory approaches in place. The degree of industry change that has occurred does not necessitate a complete overhaul of the regulatory framework at this point in time.

In the opening round of comments, Public Counsel offered several proposals for improving the processes for economic regulation. We suggested adoption of a policy statement recognizing DCF as the accepted methodology for computing the fair rate of return. This change can reduce some of the burden of the rate case process. We also suggested that a generic rate of return calculation and a generic cost of service methodology be considered. These proposals will address a specific goal: the improvement of the administrative efficiency and effectiveness of Commission processes.

In contrast, many parties offer their general endorsement of performance based regulation (PBR), but fail to identify a problem with the application of current regulatory methods.

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[5] Northwest Power Planning Council -- Washington Members, First Round Comments, p. 19.

Public Counsel agrees with the position set forward by the Northwest Power Planning Council on this issue:[6]

> *Before looking at performance based ratemaking it is important to ask and answer what the nature of the problem is and what sort of performance should be rewarded. Current rules suggest that the utility should be rewarded for following a least cost plan. If another criterion is more appropriate, the discussion should focus on why such a criterion is superior to a least cost planning criterion.*

Furthermore, it is not obvious how performance based regulation, in all of its various forms, responds to purported changes in the industry, which, as mentioned above, have yet to be identified and substantiated. Once there is general consensus as to the current status of the industry and a determination that current practices are unresponsive, then a discussion of alternatives, including PBR, should take place.

II. Response to Specific Rules

A. Least-cost planning

Commenters offered very different opinions about least-cost planning. Some advocated the status quo. Others would enhance the process and use it as the foundation for some type of prior approval of utility investment decisions. Still others would eliminate the requirement that utilities conduct least-cost planning in a public process.

Public Counsel continues to support the Commission's least-cost planning requirement, for the reasons stated in our initial comments. This requirement is crucial for effective oversight of regulated utilities, regardless of how one comes down on the question of competition in the wholesale power markets. Even if one concludes that wholesale competition exists, utilities still have to make decisions about how to select resources from that competitive market. The utility monopoly of retail service remains, and the public's only protection from incompetent or imprudent utility decisions is Commission oversight. Least-cost planning is a key tool in that oversight, and it would be foolish to eliminate or weaken least-cost planning on the misplaced notion that wholesale competition will eliminate bad decisions.

However, we believe that some parties may be confused about the relationship between least-cost planning and regulatory oversight of utility decisions. We view the current least-cost planning rule as one that merely requires regulated utilities to

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[6] Northwest Power Planning Council -- Washington Members, First Round Comments, 11.

"show their work" — to make public their plans and the factors and assumptions that led to those plans. In this regime, the plan that results is without a doubt the utility's plan, on which the interested public may comment and the Commission may accept or reject. The rule does not provide for the Commission to force a utility to adopt a particular course of action nor punish a utility that fails to follow through on its plan. The utility, therefore, cannot use its least-cost plan as a substitute for its responsibility to make reasonable, prudent decisions.

We see little problem with this result. The least-cost planning rule, after all, was not the first requirement that utilities operate efficiently and at minimum cost; regulators have always expected that of utilities. Least-cost planning is properly viewed as a modest step, within the tradition of cost-of-service regulation, toward a more open planning process. Problems arise only when utilities argue that by going through the least-cost planning process they have received regulatory approval for future actions that may be discussed in the plan.

On the other hand, we see many problems with the alternative suggestion to make least-cost planning a forum for Commission approval of specific utility decisions. The state Power Planning Council members, for example, suggest the Commission might approve, rather than acknowledge, plans "as a basis for conditional support of investment priorities."[7] The Energy Office recommends, as a supplement to least-cost planning, implementation of "a limited preapproval or rolling prudence proceeding."[8]

If the Commission were to substitute least-cost planning for traditional requirements for prudent utility decision-making, the current planning requirement would be insufficient in the extreme. The public would be entitled to the same level of scrutiny in least-cost planning dockets that is now applied to important utility decisions in general rate cases. However, the beauty of Washington's least-cost planning rule is that it is a simple rule that affords change as the state of the art changes. One need only compare the first plan prepared by Puget Power in 1987 with the most recent plans of various utilities to understand this point. We are not optimistic that the same quality of planning — or the same level of regulatory scrutiny — would result if the Commission were to turn least-cost planning into a prescriptive regime used for some form of prior approval.

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[7] First Round Comments of the Northwest Power Planning Council - Washington Members, p. 7.

[8] Comments of Washington State Energy Office, p. 31. Emphasis in original.

It has been suggested by several commenters that the Commission should make least-cost planning a less public process.[9] This suggestion apparently arises from the notion that utilities will suffer a competitive disadvantage if they plan in the open. Public Counsel disagrees with this argument and urges the Commission to reject it. One of the keys to the success of least-cost planning has been its requirement that utilities open the process to the public. Utilities, after all, planned for the future long before the Commission adopted its rule, and they presumably did so with the objective of providing reliable, least-cost service. What changed in 1987 with the adoption of the least-cost planning rule, therefore, was not the act of planning but the setting in which the planning took place.

Proponents of a closed process offer no example of harm that has resulted from open planning and decision-making.[10] Rather, the harm has come in closed processes such as competitive bidding solicitations. Utilities have wrapped a veil of secrecy around the proposals, the utility evaluations, and the eventual purchased power contract. In the Puget Power prudence case, for example, we suspect that the dispatchability and end effects errors identified by the Commission would not have been repeated in contract after contract if the bids and contracts had not been hidden from the public until the prudence case was under way. Public Counsel believes the Commission has an obligation to protect the public's right to information and that competitive, efficient markets will be best served by vigorous protection of that right. It certainly would not be in the public interest to close another door on the public.

B. Bidding

The current practice of regulator-mandated and -approved resource solicitations appears to have varied support among commenters. WICFUR supports a continuation of the rule though not for the resources that would serve its loads. NCAC would require it, but only if the utility intends to acquire resources through that process. Pacificorp is not opposed to the process but sees little value in it. It appears that most other

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[9] Initial Comments of O'Neill and Company, p. 8; Pacificorp's Response to Washington Notice of Inquiry, p. 13; Response of Puget Sound Power & Light Company, p. 8; Comments of Ragen MacKenzie, p. 2; Washington Water Power, p. 9.

[10] Indeed, truly competitive markets are marked by ready access to information about prices. The ability of market participants to make transactions in the same market at different prices (which is what utilities and power producers hope to accomplish through secrecy arrangements) is an indication that markets are not truly competitive.

commenters either favor the elimination of the existing rule or express no opinion on the question.

In our initial comments, Public Counsel said that the bidding mechanism had yet to prove itself and had as yet provided no tangible benefits. We reviewed our continuing concern with the mechanism, but we were unable to recommend specific improvements to the process. Taken as a whole, the first-round comments suggest to us that it is possible that the bidding rule could be abandoned with no adverse impact. Public Counsel encourages the Commission to begin an analysis of whether to substantially alter or repeal the existing rules.

The current bidding rule does not appear to be an efficient method of acquiring resources. While utilities are required to solicit proposals, they are neither required to live with the results of the solicitation nor prohibited from acquiring resources outside the formal process. We see two alternatives, either to require that utilities use formal competitive bidding as the exclusive means of resource acquisition or to remove the requirement that utilities conduct these solicitations. We believe the former option would actually hinder competition in the wholesale market, and it would likely increase costs to consumers. The wholesale power market is not a pure commodity market, comprised of many sellers offering homogeneous products; some good resources simply will not survive the expense and delay inherent in a formal bidding process. This fact is already recognized in the current policy of allowing utilities to acquire resources outside the bidding process.

In considering the repeal of the competitive bidding requirement, we are not recommending that utilities remove themselves from the wholesale power market nor that they abandon competitive bidding as a tool for efficient resource acquisition. Utilities should continue to be held to the least-cost requirement, and independent projects should be acquired when they are cheaper than the utility's own options. A formal competitive bidding process in some circumstances will be the best way to acquire the low-cost resources and to demonstrate to customers and regulators that the utility has done the best job possible.

If the competitive bidding rule were to be repealed, there are several issues that must first be addressed by interested parties and decided by the Commission. The primary issue is how utilities will meet the requirements of PURPA, since their obligation to purchase power from qualifying facilities is not met through bidding.

III. Recommendations for Next Steps

A. The Commission should clarify the policy goals and values guiding a restructuring discussion

Many parties including Public Counsel presented their ideas of what broader goals and values should be pursued in any restructuring effort. With the body of comments as a starting point, the Commission needs to provide guidance as to the broader objectives and goals that must be considered by all stakeholders in any restructuring discussion.

The Commission should identify the core issues and insist upon quantification and meaningful, fact-based analysis, not conclusory or anecdotal comments.

B. Caution regarding workshops

The comment rounds in the NOI provided the opportunity for parties to develop and share their opinions on the changing environment of the electricity industry. The challenge now is to separate the issues into sub-issues that allow for productive dialogue and progress.

Workshops, if they are the next step, must be very focused to be of any value. We have seen workshops in which participants merely repeated their written comments. We urge the Commission to utilize a process that elicits verifiable factual information, and then rigorously focuses discussion on policy implications.

DATED: April 28, 1995.

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OFFICE OF GENERAL COUNSEL

April 27, 1995

Steve McLellan
Commission Secretary
Washington Utilities and
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Re: Notice of Inquiry Examining Regulation of Electric Utilities in the Face of Change in the Electric Industry, Docket No. UE-940932.

Dear Mr. McLellan:

Enclosed for filing in the above-captioned docket are an original and 11 copies of the Bonneville Power Administration's Response to the First Round of Party Comments to the Commission NOI on Regulatory Restructuring ("Comments"). We would appreciate it if you would date stamp one of these copies and return it to us in the enclosed postage-paid, self-addressed envelope. We also enclose a disk containing the Comments formatted for Word Perfect 5.x for Windows.

Thank you for your assistance and consideration.

Sincerely,

Nancy P. Baker
Attorney

Enclosure

BEFORE THE

UTILITIES AND TRANSPORTATION COMMISSION

OF THE STATE OF WASHINGTON

NOTICE OF INQUIRY Examining Regulation of Electric Utilities in the Face of Change in the Electric Industry	)))))	Docket No. UE-940932

BPA Response to the First Round of Party Comments to the Commission NOI on Regulatory Restructuring

In the first round of responses to the Washington Utilities and Transportation Commission's (Commission) Notice of Inquiry (NOI), Bonneville Power Administration (BPA) identified issues that could have an impact on the determination of Average System Cost (ASC) for utilities participating in the Residential Exchange Program (Exchange). One of the key features of BPA's response was an explanation of BPA's "jurisdictional approach" for ASC determination. This approach relies upon itemized cost data approved by state regulatory commissions (in the case of investor-owned utilities). Costs that are not first approved by a regulatory commission or a utility governing body cannot be submitted for inclusion in ASC. A significant concern for BPA as the Commission considers regulatory changes is the continuing availability of the data needed for ASC reviews. After reviewing the first-round comments on the NOI from other parties, BPA's concerns about availability of the needed data remain. In addition, BPA recognized further issues which may have ASC implications: the comments below build on BPA's first-round response. Exchange related comments in both rounds reflect BPA's current observation on the ASC issues identified. As more detailed information becomes available in the Commission NOI process, BPA may identify additional issues.[1]

[1] BPA would, at this time, like to make a correction to its Initial Comments to the Commission's Notice of Inquiry. On page 2, section 1, paragraph 2, BPA's position is more accurately reflected by the following revision:

> Deregulation has opened the door to new competitors, including independent power producers (IPPs); marketer firms, broker firms and energy services firms. Southern Electric International (Southern), an IPP and subsidiary of The Southern Company, is exploring service to load in the region. Southern has told BPA that it has allocated $1.2 billion in capital investment for the region over the next ten years.

Conservation

At least one party suggested that the Commission adopt rules that would allow utility recovery of investments in conservation resources that do not pass the "total resource cost" test. The 1984 ASC Methodology (ASC Methodology), which directs how BPA determines ASC, requires that conservation costs be "consistent" with the Northwest Power Planning Council Plan (Plan) in order to be exchangeable. Cost-effectiveness tests are an important part of determining consistency with the Plan. BPA encourages the Commission to retain tests that address cost-effectiveness standards for conservation expenditures. Regardless of the tests employed in jurisdictional processes, BPA has the responsibility under the ASC Methodology to make an independent determination of reasonableness and appropriateness of conservation costs included in ASC. Further, this independent determination responsibility applies to all other sections of this response.

Market Structure

Changes in market structure will affect both the transmission and generation portions of exchanging utilities' ASC. Introduction of statewide or regional pooled transmission would likely change the transmission portion of utility ASC by shifting utility-specific transmission costs from their current level toward a statewide or regional average. A market structure based primarily on bilateral agreements would probably not effect the transmission portion of a utility's ASC.

Direct access to generation resources, either through pooled transmission or through bilateral agreements, will likely reduce the costs of generation resources through increased competition in the generation sector of the industry. However, due to customers leaving utility systems through direct access, average generation costs for retail ratepayers that remain could increase if fixed utility generation costs are recovered from a smaller base of core utility customers. Further, exit fees (or transmission rate adders) may not be sufficient to recover all fixed generation costs associated with direct-access customers leaving utility systems. This under recovery may result from the method(s) of calculating the exit fees, time limitations on collection of fees, etc. Due to the link between generation costs included in retail rates and ASC, BPA believes that average generation costs submitted for inclusion in ASC would be likely to increase. BPA will need to thoroughly examine the generation costs included in the rates of remaining utility customers to determine whether they are reasonable and appropriate for inclusion in ASC.

As a matter of principle, BPA endorses the Public Counsel's position (p. 27 and p. 29 of Public Counsel's comments) that a utility's existing retail customers should not subsidize a utility's competitive power marketing ventures through discounts for customers outside the utility's service area. This would distort markets and be unfair to both existing retail customers and to competitors in those power markets.

BPA is also concerned about ASC issues related to regulatory assets. Regulatory assets could include, among other things, stranded utility investments, abandoned plant costs, and utility settlements. When determining the reasonableness and appropriateness of

costs included in ASC, regulatory assets will be addressed by BPA on a case-by-case basis.

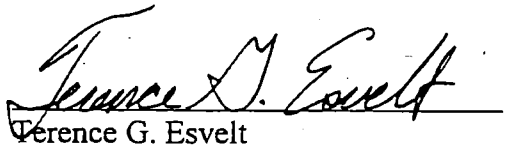
The effects of new market structures on the administration of the Exchange are dependent not only on the market structure adopted, but also on related ratemaking mechanisms. Changes in market structure may be accompanied by ratemaking methods in the Commission's jurisdiction (such as performance-based ratemaking) that are not compatible with the information requirements of the existing ASC Methodology. As BPA noted in its first-round comments, non-cost based ratemaking may not provide BPA with the data necessary to perform ASC reviews under the existing ASC Methodology.

Jurisdictional / Commission Prudence Review

Many comments in the first round of the NOI made suggestions for changing or eliminating jurisdictional resource prudence reviews (prudence reviews). BPA acknowledges that the need for prudence reviews may be lessened as competition or performance-based ratemaking is implemented.

Many respondents suggested changes to prudence review timing, including the possibility of "pre-prudency" review. As an alternative, BPA sees a potential synergy for BPA, the Commission, and utilities by building features of prudence reviews into the rate case process: Combining rate case and prudence data collection, analysis, and decisions into similar timelines may significantly reduce the effort required to meet prudence investigation objectives, resulting in time and cost savings.

DATED this 27th day of April 1995.



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Reply to Washington, D.C. office

April 27, 1995

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RE: Docket No. UE-940932

Dear Mr. McLellan:

Enclosed for filing in the above referenced docket are an original and 10 copies of the Reply Comments of the Center For Energy and Economic Development. We are serving copies on each of the parties that filed initial comments in this docket. We are also enclosing a diskette containing the reply comments. Further enclosed is an additional copy which we ask that you stamp as received and return in the enclosed self addressed and stamped envelope. Thank you very much.

Sincerely

Peter Glaser

Enclosures

STATE OF WASHINGTON
BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

Docket No. UE-940932	Examining Regulation of Electric Utilities in the Face of Change in the Electric Industry

REPLY COMMENTS OF THE CENTER FOR ENERGY AND ECONOMIC DEVELOPMENT

I. INTRODUCTION

Pursuant to the Commission's March 17, 1995 notice, the Center for Energy and Economic Development (CEED) submits these Reply Comments in response to the first round of comments in this docket. CEED is a non-profit organization formed by the nation's railroads, coal producing companies, a number of electric utilities and related organizations for the purpose of participating in state and regional regulatory proceedings affecting the utilization of coal by electric utilities.

Our reply comments respond to the comments submitted by the American Wind Association, Greenhouse Action, NW Conservation Act Coalition, Natural Resources Defense Council, and NW Environmental Advocates. Each of these organizations took the position in its comments that, despite competition, the Commission should utilize its regulatory authority to promote social goals. Each of these organizations would have the Commission compel regulated utilities to acquire demand and supply resources that are not cost-effective and which the utilities would not otherwise acquire in a competitive market because of the presumed benefit to society at large of these

resources. These organizations advocate the use of such devices as environmental externalities, renewable set-asides and even what NRDC (p. 6) characterizes as a "Volume-Based System Benefits Charge" to support their social policy objectives.

It is well recognized that as the electric industry moves towards competition, the major problem facing regulators is stranded investment. Stranded investment are utility generating assets that are uneconomic and will not be dispatched as electric consumers are given control over their electric supply. It is estimated that there may be billions of dollars of investment in the American electric utility industry that could become stranded as the market becomes more competition.

Forcing utilities to purchase new uneconomic resources at this time - as the market moves towards competition - is a prescription for even more stranded investment. The issue for the Commission in considering the proposals for the use of social factors in utility resource acquisition is not whether the Commission agrees or disagrees with the social goals being promoted. Given competition, the issue is whether it is possible to achieve those goals through regulation by this Commission. We submit that the increasingly competitive nature of the market means that this Commission cannot "sustain" a policy of pursuing social goals. Forcing utilities to acquire uneconomic resources in a competitive environment simply means that those resources will become stranded. They will not be dispatched.

Our reply comments are organized into two sections. First, we show that the movement towards competition in the electric industry is now irreversible. Second, we show that, given competition, the Commission must move away from the promotion of social goals.

II. ARGUMENT

A. THE MOVEMENT TOWARDS COMPETITION IN THE ELECTRIC UTILITY INDUSTRY IS NOW IRREVERSIBLE.

This is a point that needs to be reemphasized. The electric utility industry is now in transition from an industry in which regulators dictate utility actions to an industry where an increasingly competitive marketplace will dictate utility actions. This movement towards competition is taking place largely beyond the control of this Commission. The Energy Policy Act of 1992 established competition and deregulation as goals of national energy policy by creating a new class of Exempt Wholesale Generators and providing for open-access transmission. The Federal Energy Regulatory Commission has enthusiastically endorsed these goals and is in the process of making a number of fundamental policy changes to ensure an increasingly competitive industry. FERC has just recently issued its long awaited Notice of Proposed Rulemaking (Docket No. RM95-8) on open-access transmission which provides for sweeping changes in the transmission system in order to make competition possible. In addition, FERC has recently issued a new interpretation of the Public Utility Regulatory Policies Act ("PURPA") in light of its

policies promoting competition (Docket Nos. EL95-16-000 and EL95-19-000).

The Department of Energy recently commissioned the EOP Foundation to review the state of the industry. In August 1994, EOP issued its report characterizing the industry and its future as follows:

- Changes in statutes (e.g., PURPA of 1978, Energy Policy Act of 1992), regulations, and regulatory agency decisions resulting in or threatening:
  - Competition in generation from non-utility generators (NUGs).
  - More open access to transmission facilities as a result of the Energy Policy Act of 1992 and FERC regulatory decisions.
  - Competition in wholesale markets, in part due to increased transmission access.
  - Increased competition in serving retail customers, due to state legislative and regulatory actions.
- Aggressive actions by industrial and commercial customers to reduce electricity costs, particularly if they are facing increased competition and cost pressures.
- Self-generation (including cogeneration) by commercial and industrial customers.
- Actions by some municipalities (sometimes encouraged by commercial and industrial firms) to establish municipal utilities that are eligible to buy power competitively on a wholesale basis.
- Aggressive action by utilities with excess capacity to capture other utilities' wholesale customers.

- Growing action by utilities and regulators in providing lower rates for industrial firms to encourage them to expand, to increase employment, and not to move.

- Emergence of brokers and marketers and, potentially, an electricity futures market.

- More exacting customer electricity needs (e.g., more stable voltage, no interruptions) leading to growing customer concern about "power quality."

- Competition from other energy sources, including interest by regulators in the potential for "fuel substitution" in end uses (e.g., using gas in lieu of electricity).

- Increasing competition from other independent energy service companies (ESCO's) that provide services on the "customer side of the meter."

- A continuing conflict between PUC requirements that utilities assist customers in adopting demand-side measures and electrical contractors' objections to such activities.

EOP Foundation, "A Report to the U.S. Department of Energy on the Role of Integrated Resource Plans (IRPs) in a Rapidly Changing Electric Industry," August 23, 1994 ("DOE Report"), pp. 6-7.

Similarly, the Washington International Energy Group, which publishes annual surveys of electric utility executives, recently reported as follows:

> This year's survey results suggest the North American electric utility industry is now in long-term play. 1994 will be remembered as the year in which the industry as a whole recognized that competition was the permanent driving force beyond the control of anyone -- and not merely a passing phase. Judging from our survey, senior managers in more utilities in North America experienced a fundamental psychological transformation than in any other year in the modern history of North

> America's utilities. After years of deep division over the most desirable course of action for the industry, again, there is virtual unanimity. The market is in change.
>
> 1995 promises to be the year in which this new reality continues to permeate utility decision making. Decisions are no longer being made based on how regulators will respond, but based on what will sell. Throughout this year's Outlook we have found ourselves using the world "real" to describe what is happening. We believe it is the right word to use to show that competition is no longer an issue for economists and strategic planners; it is a reality that every employee, manager, and shareholder must understand and incorporate into every action.

Washington International Energy Group, The 1995 Electric Industry Outlook, page 4.

B. THE MOVEMENT TOWARDS COMPETITION MEANS THIS COMMISSION MUST LOOSEN RATHER THAN TIGHTEN ITS REGULATORY CONTROL OVER RESOURCE PLANNING, AND IT MUST DEEMPHASIZE "SOCIETAL" GOALS.

The initiation of this docket reflects the Commission's awareness of the tension between the movement towards competition and the use of IRP to govern utility resource acquisition. In fact, IRP is in many ways directly antithetical to a competitive marketplace. IRP is a process by which various "stakeholders" are invited to join with the utility in the planning of electric resource development under the centralized command and control of the utility commission. The theory is that working together, the utility, "stakeholders" and commission can collectively decide the best resource plan for the utility, which the utility is then obligated to follow.

In a competitive marketplace, this centralized control has no place. Resource acquisition decisions are determined by the market. Businesses in a competitive market, of course, are still subject to regulation in the areas of the environment, health and safety, etc. But to the extent a business complies with applicable regulation, it is free to make business decisions in light of the dictates of the market. No central authority tells it whether there is a need for the business to acquire new equipment, when it may acquire the equipment, from whom it may acquire the equipment and how much it may pay.

No one would argue that the electric utility industry has achieved perfect competition and that this Commission's regulatory mission is at an end. However, as the industry moves towards more competition, it is appropriate for the Commission to consider areas in which its regulatory mission may be reexamined.

One area that is ripe for reexamination is the degree to which IRP and other regulatory functions can continue to be used to achieve social or "societal" goals, including environmental goals. As the Commission is aware, electric utilities in Washington are currently subject to a host of environmental regulations stemming from, among other requirements, the Clean Air Act. These regulations are directed at assuring that powerplant air emissions are within levels that cause no harm to human health with a margin of safety and with no consideration of the economic costs of requiring such emissions levels. 42 U.S.C. §7409. Where violations exist, EPA and state environmental

regulatory authorities are required to have in place a plan for addressing the violations.

Despite the comprehensive nature of environmental regulation, the commenters identified above advocate that this Commission provide for additional environmental safeguards. The Commission is asked to set standards that would promote renewable resources and DSM that are not otherwise cost-justified in the marketplace. NRDC even seeks the imposition of what it calls a Volume-Based Systems Benefits Charge, which is a thinly disguised tax to promote renewables and DSM.[1] These commenters believe that it is socially desirable to promote these resources, and they ask this Commission, in effect, to create a market for the acquisition of these resources.[2]

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[1] NRDC's proposal for a Volume-Based System Benefits Charge of up to five percent of customers' utility bills is an audacious way of getting around the stranded investment problem. NRDC would have this Commission levy what is in effect a sales tax on use of the electric distribution system. NRDC's theory is that such an approach will not create stranded investment because most consumers will not be able to bypass the distribution system. They are stuck and have no choice but to pay the tax. For both legal and policy reasons, we strongly suggest that this Commission defer to the legislature on matters of tax policy. If NRDC believes that a social policy tax is in the public interest, it should take the matter up with the State's elected representatives. It is outrageous even to suggest that this Commission, without explicit legislative authority, should impose a tax on customer bills for social ends.

[2] CEED is amazed that parties in this proceeding are calling for the imposition of monetized externalities. Given the trend towards increased competition, there is less reason than ever to utilize monetized externalities, as a number of states have recognized. We attach a copy of a recent decision of an Administrative Law Judge in New York recommending that the New York Public Service Commission eliminate its requirements for environmental externalities. Case No. 92-E-1187, Recommended Decision by Administrative Law Judge, April 12, 1995. The ALJ

But creating a market for non-cost effective resources in the face of increasing competition is a dangerous game. Each non-cost effective resource that a utility is forced to acquire is a resource the utility will not be able to dispatch or earn a return on to the extent customers have competitive choices. Such resources may become unused and unuseful "stranded investment."

Utilities do not bear the sole risk from these policies. The ones most at risk are the utility's residential customers. As the market moves towards competition, large industrial and commercial customers will increasingly be able to free themselves from high priced suppliers, and not just by moving off system to

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(pp. 12-24) reasons that the use of monetized externalities is inconsistent with economic theory, is contrary to sound regulatory policy and will not lead to environmental benefits at least cost. With respect to how monetized externalities relate to a competitive marketplace, he writes (p. 21):

> It should also be noted that what the proponents in essence seek is the governmental establishment of a "correct price" to be used for externality costs. Whenever government has attempted to set similar prices in the past, whether they be IPP sales prices, natural gas, oil and gasoline prices or the price for nuclear fuel, the results have rarely maximized social welfare; and, when such prices are imposed in a market subject to some level of competition, the results are often contrary to the original government goals.

We would also note that the Massachusetts courts have recently struck down that state's monetized externality system, Massachusetts Electric Company v. Department of Public Utilities, Case No. SJC-06483, Supreme Judicial Court (March 21, 1994), and the Illinois Commerce Commission has recently decided not to adopt monetized externalities, Order in Docket No. 92-0274, Illinois Commerce Commission (November 23, 1994).

a different supplier. As this Commission is well aware, large electric customers are demanding and receiving special rate breaks from utilities in order to stay on system. As large customers are able to "skim the cream" from the electric generation market, it is the small customers - those without bargaining leverage and with limited competitive choices - who will be left to pay for the non-cost effective resources. The hard fact of the matter is that, in a competitive marketplace, requiring utilities to purchase non-cost effective resources will make them uncompetitive with unregulated energy suppliers and create stranded investment that may ultimately end up being paid for by those least able to pay. As the EOP Foundation noted for the Department of Energy (see Executive Summary):

- Many of the state policies and regulations governing electric utilities, including requirements covering integrated resource planning, have evolved during a period when almost everyone assumed that electric utilities would continue to have a monopoly. Policies and attitudes toward the industry that have prevailed for decades will no longer be appropriate.

- Integrated resource planning, while having contributed useful and productive changes in the electric utility industry, also imposes costs and provides for the framework for creating requirements that add to the cost of electricity provided to customers by regulated electric utilities that are not imposed on current and prospective customers. Already, regulated and unregulated entities are competing to provide some of the same products and services (e.g. generation of electricity), with the regulated entities at a cost disadvantage because of requirements imposed under existing regulations. This situation is unlikely to produce the lowest price for consumers because the regulated

entity will not be in a position to be fully cost competitive with others.

- As services are unbundled and priced separately, costs and cross-subsidies that are imposed on the industry for purposes other than providing an adequate and reliable supply of electricity will become more visible than in the past.

- DOE should encourage states to recognize the changes and developments underway in the electric industry and reconsider their existing policies and requirements in light of these changes, particularly those that may be unnecessarily impeding beneficial competition or adding cost. (Emphasis supplied.)

Writing in the October 1994 Electricity Journal, Alfred Kahn stated similarly that:

> The question is not whether the competitive market achieves optimum levels of conservation without assistance. It probably doesn't. Or whether it protects the environment. It certainly doesn't. The question is whether we are going to correct those deficiencies by preserving public utility monopoly and micromanaging it, as at least some conservationists and environmentalists want to do; use the power of the monopoly, protected from competition, to tax ratepayers and use the proceeds to do these virtuous things.
>
> By far the better course if we see competition coming, I submit, is to embrace it as the best way of serving the consumer interest and then take care of its possible deficiencies in achieving efficient conservation and preserving environmental values in ways such as taxation or transferrable emissions rights that are competitively neutral and make use of the efficiency of the market, rather than override it by regulatory micromanagement. It may of course be politically easier to accomplish those worthy social purposes by regulators making the utility companies undertake the good works while passing the

> costs onto the ratepayers. It is also, however, profoundly anti-democratic and potentially inefficient - that is to say, injurious to consumers. (Emphasis supplied.)

Alfred Kahn, "Can Regulation and Competition Coexist? Solutions to the Stranded Cost Problem and Other Conundra," Electricity Journal, October, 1994.

The incompatibility of competition and command and control management to achieve social ends has also been recognized by the California Public Utilities Commission in its order establishing its retail wheeling docket:

> We believe there no longer remains a place in the competitive vision that EPA Act articulates and fosters for the complicated, government-sponsored central planning California has practiced. The laws that created and now dictate planning in California were more necessary and appropriate when vertically integrated, investor-owned monopolies dominated the electric services landscape; when the nation faced an imminent threat to its security of supply; when inflation was high; and when utility demand forecasts and construction costs were high as well. <u>None of these conditions remains</u>. Most significantly, the utilities face a mature, financially and technically competent, and considerably influential nonutility power industry, which increasingly includes utility affiliates. (Footnotes omitted, emphasis supplied.)

<u>See</u> California retail wheeling docket, Order Instituting Rulemaking and Order Instituting Investigation, R. 94-04-031 and I. 94-04-032 (California P.U.C. April 20, 1994), at 48. The California Commission went on to say that:

> ...we believe the time is ripe to reexamine the appropriateness of mandating that the utility act as the principal agent charged with designing, implementing and bearing the costs of those programs. Competition and

> restructuring in the electric services industry is for the most part taking place beyond the reach of regulatory jurisdictions. As competition's hold on the industry tightens, and the pace of change quickens, the ability of the utility, or any other service provider, to absorb unilaterally the costs of these programs, and simultaneously compete for consumer loyalty and market share, will diminish significantly. (Emphasis supplied.)

See Order Instituting Rulemaking, supra, at 56.

Of course, as these and other authors have noted, a reduced role by state utility commissions in social regulation does not mean that social regulation of utilities will disappear. Far from it, and as noted, utilities remain subject to a host of environmental and other social regulations (Clean Air Act, Clean Water Act, etc.), as do other energy companies. And utility commissions will retain their traditional roles as economic regulators in ensuring that utilities implement social and environmental requirements in the least cost fashion for ratepayers. What this Commission needs to be skeptical of, however, is the extent to which it can maintain a social regulatory role. We suggest such role must and will be limited.

III. CONCLUSION

In sum, the Commission must recognize that it cannot impose social costs on utilities as the market moves towards competition. Such impositions will create stranded investment and will not achieve their social goals. Competition means that this Commission must return to its role as an economic regulator. Social regulation must be left to the social regulatory agencies.

Dated: April 27, 1995

Respectfully submitted,

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Attorney for the Center for
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CERTIFICATE OF SERVICE

I certify that on April 27, 1995, I served a true copy of the foregoing Reply Comments of the Center For Energy and Economic Development on the parties listed on the attached Service List via first class mail.

Peter Glaser

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April 26, 1995

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RE: Docket No. UE-940932, Phase Two
Notice of Inquiry: Examining Regulation of Electric Utilities
in the Face of Change in the Electric Industry

Dear Mr. McLellan:

Enclosed are the original and ten copies of written comments submitted by Global Village Communications and Fred Zagurski Consultants. Also enclosed is a 3-1/2 inch, high density disk containing the comments in Microsoft Word 5.0 format.

Sincerely,

James Bledsoe, Ph.D.
Principal

Fred Zagurski

Fred Zagurski, CPP
Principal

The Need to Develop a Model for Evaluating Security and Performance Issues in the Face of Change in the Electric Utilities Industry.

by

James Bledsoe, Ph.D. & Frederick Zagurski, CPP

Docket Number: UE-940932, Phase Two

April 26, 1995

Problem Statement:

There is a movement afoot to deregulate the electric utility industry and hand over the very heart of Washington's economy to a competitive marketplace. In addition, the structure of the electric power industry appears to be moving toward a greater number of owners and a more diverse ownership of electricity generating capacity as well as smaller generating units.

Perhaps the most difficult problem in handing this part of the economy over to open competition will be deciding what the appropriate level of reliability and security should be for the state's entire electricity supply under these newly proposed conditions.

Putting aside the issue of cost for a minute, let us ask the following question: Do we have a reliable electric system in the state of Washington? Let us assume that we do. What then will the impact of competition be on this system? Can the new owners and the companies, who this system will be turned over to, demonstrate the wherewithal to maintain and operate the system safely? What assurances do we have that a deregulated service environment will have the necessary capital investment, the necessary maintenance investment, and the necessary security investment to guarantee reliability of supply?

Furthermore, what are the means available for estimating the cost of disruptions and outages to this system in a newly deregulated service environment?

Such difficulties arise when directly estimating the demand for future electricity needs, using forecasting methods and data developed in the industry's earlier regulated service environment. The appropriateness of past decision-making tools seems now to be problematic. Suddenly, factors that have historically affected the planning of reliability and security on the power grid are obsolete.

Two Important Questions That Blend Together. The fundamental economic question regarding reliability and security is: How much do we want to pay for what level of reliability? The fundamental sociology question regarding reliability and security is: What are the social costs and unexpected consequences for neglecting to address this problem now? These two fundamental questions offer suggestions and lessons about the latent energy contained in cultural change's uncertainty. The compounding of these two questions together offers an especially favorable opportunity to notice all the kinds of social and psychic energy that will develop and blend together as the electric utility industry moves into a new deregulated service environment. One of the responsibilities that the citizens of the state of Washington have at this point is to develop a new formula for balancing the issues of open market competition with the necessity for power grid reliability and security.

Finally, in the rush to deregulate the electric utility industry, what is being done to maintain public confidence? Will the rush to deregulate the industry discourage market investment that will bring the needed monies for maintaining the system in good working order?

Performance & Security Issues for a Changing Electric Power Industry.

There is a major shift in economic normality inside the electric utilities industry today. Previously, we needed a normal economic stability, with some "controlled risk and uncertainty" for paradigms of regulation to work. When instability became widespread, it was called a crisis. But today, in the whole economy, we have come to consider "as normal" the widespread instability of the constantly shifting flow of goods and services. Under such conditions, the need for stability is beginning to be seen as "abnormal", since "stability", as it was once known, appears to contradict the march of new service techniques in a variety of deregulated service environments; such as, in manufacturing where short production runs for an ever wider variety of products is becoming the norm; in publishing where more specialized interest publications with smaller numbers of readers is now common practice; in education where an increased number of courses are proposed and introduced into school curriculums reflecting the loss of complete faith in the unifying force of the democratic creed; or in politics where an increasing number of cranky self-interest groups form into a nation of indelible group identities instead of a nation of individuals exercising free choices.

All these economic and social shifts require the consideration of trade-offs. In order to obtain one thing, we must give up something else, or put more succinctly, everything has a cost. Reliability and security of Washington's electricity supply is no exception to this rule. It will cost more to produce and deliver higher levels of reliability and security. Unfortunately, economics studies usually assume that production is occurring in the least cost manner. Thus they have little to say about reducing costs while producing the same amount of electricity with the same security and reliability.

Today, there is a need to develop a new model for developing security and performance precautions in the face of change in the electric utility industry.

A new type of reliability of supply problem is emerging as the electric utility industry faces the greatest challenge since its inception. The industry's traditional social and economic models of accountability and authority have been impoverished. Therefore, there is as much need to reexamine the *internal problems* of the industry as there is to explore the *external problems* of changing market conditions. The potential for customer dissatisfaction, employee fraud and embezzlement, employee violence, property destruction, sabotage, computer viruses and petty white collar crime cannot be ignored because such phenomenon do not fit into the commonly accepted models of risk and uncertainty. Hence:

- Distinctions between trust and malfeasance must be identified in order to spot the differences caused by fraud, or bad policy, or errors in judgement,
- Forensic procedures must be developed to train accountants to spot embezzlement,
- Education and training policies must be implemented to help alert security and human resource personnel to threats of workplace trauma and violence, and
- Security design measures must become an integral part of the industry's transition stage instead of a costly energy-grid retrofit across the industry later on.

In this time of uncertainty and risk, we know one thing for certain. When *any* industry with a stable past changes hands or deregulates, the risk of aberrant social behavior in that industry increases. Although the number of cases is small for each industry, their social and economic costs are extremely high. Public confidence erodes and ironically, stricter rules and regulations are often called for. For instance, in the savings and loan industry, 30 people were responsible for $10 billion worth of red ink. In the airlines industry, 1 disgruntled former employee was responsible for the December 7, 1987 tragedy involving Pacific Southwest Airlines (PSA) Flight 1771, in which 38 passengers and 5 crew members were killed after departing Los Angeles International Airport. This one incident resulted in a $169.9 million (in 1987 dollars) security retrofit to provide enhanced control of access to secured areas at airports throughout the U.S.

Moreover, capital markets also provide contexts and evidence of the impact of aberrant behavior on the cost of service reliability and the value of life. In 1990 researchers found that industrial fatalities such as airplane crashes and hotel fires were valued by stockholders at $50 million per death. Such a high estimate reflects private valuations of risk by consumers of the firm's products, the total cost of tort awards, and possibly a lowered assessment of the overall quality of the firm's operations as well. What is disturbing is that these incidents are becoming more frequent in the workplace. Furthermore, they are so horrific that they capture national and global attention and impact the ability of businesses to generate additional capital investment needed to guarantee reliability of service or supply.

Such episodes make the need for developing a formula for balancing the issues of open market competition with power grid security and reliability seem more important than ever before. Several other recent incidents of aberrant social behavior show just how vulnerable open and competitive markets can be to security and reliability risk. Events such as the arson fire at the Mary Pang Food Company in Seattle, the arson fire at the Fulton Fish Market in New York City, the bombing of the Federal Office Building in Oklahoma City, the poison nerve gas attack in the Tokyo Subway System, the $1.7 billion derivative speculation disaster in Orange Country, California, and the $1.5 billion financial calamity to England's oldest investment firm all bring the electric power grid security issue into high relief.

Speaking about the demise of England's oldest financial investment firm, Federal Reserve Chairman, Alan Greenspan made a prophetic observation which applies to our entire security and reliability problem. Although Mr. Greenspan was talking about the $1.5 billion financial loss which put a venerable 233 year-old banking establishment out of business, he could just as well have been talking about the incident in Seattle, New York, Tokyo, Orange County, Oklahoma City or the future reliability of the electric power industry in the state of Washington. Greenspan warned that Barings P.L.C. of Britain might not be the last institution to encounter huge losses because of the actions of an individual employee or group. "It's going to continue", Greenspan said, "basically because the technology is there for it to happen. Unless you want to reverse technology, unless you want to reverse knowledge and move the clock back, it's not capable of being eliminated. Human nature is going to do what human nature has always done, bad things on occasion. Our job is to prevent that from becoming systemic."

Whatever the cause, virtually all security problems follow a pattern:

For a time, all is going well. Then circumstances unfold as a prelude to casualty. Signs of trouble may be present, and if so, may be detected by people or machines in control, followed by some avoidance action at the interpersonal level and some complacency action at the managerial decision-making level. On the other hand, if warning signs are absent, ambiguous, obscured, delayed, or if they are misinterpreted, or if they are properly interpreted but fitting preventative measures are not taken, that episode will spill out of the workplace to eventually become a major security incident. Consequences then range from trivial to severe; angry words and threats of workplace assault, equipment theft, data destruction, computer tampering, burglary, destruction of property, arson, embezzlement of funds, violent attacks, and the catastrophic loss of life.

The upshot of all this is that the entire nation is staring at massive risk and uncertainty in the delivery of arguably our most enabling technology. For this generation of electric utility workers, regulators, and the public alike, this is a totally new experience and we must try to probe its significance.

Today, is there the right level of security on the whole electric power grid?

As the structure of the electric power industry changes, utility regulators, and power grid managers will need to evaluate the new security/regulatory relationship caused by these changes. Certainly, risk and uncertainty are beginning to take on new "uncontrolled dimensions and proportions" during this time of transition. Consequently, the electric utility industry is becoming a social and psychic frontier awash with conflicting values.

Our Concern About This Issue: Our concern is that this issue will be ignored because it falls into the classic pattern of all risk politics: The issue will be neglected until some disastrous event dramatizes the growing and dangerous flaw in the present power grid-reliability/security paradigm.

Our Position On This Issue: Probing this issue's significance in traditional ways will be difficult because the regulatory/power grid relationship still mirrors the structure of the industry's previous economic normalcy. Under the new economic conditions of widespread instability, many of the rules and regulations of public utility commissions appear to make no sense and be purely arbitrary. But for the power companies that have to operate under them, they are realities nonetheless.

It is useful to ask whether the accuracy of future reliability and security predictions is influenced by the methodologies currently employed in the industry. When normal economic stability existed in the industry, the politics of risk and uncertainty followed a classical pattern. The industry's good reputation governed the degree of scrutiny given to it by regulators, managers and the public alike. Regulators and managers who had jurisdiction over power grid-security subscribed to models of accountability which accepted the likelihood of risk as falling into safe ranges of statistical probability. Today, however, it would be fatal to be unaware of the hidden ground of tradition in the generation of such statistics. For the hidden ground of all these statistical findings is the

"economic normalcy" the industry has experienced for the last eighty years. An underlying assumption about all such statistical probability is that premises never change while quantities may vary. The logic might be tight, but today this is wing nut reasoning nevertheless. At one time, "controlled risk and uncertainty" was part of the everyday working scheme of economic normality. Probability data about future security "hazards" and their various causes could be extrapolated from the collective experience of electric utility history. Managers mindful of their margins and their rate base, would therefore neglect potential security problems until some event dramatized its hidden danger to regulators and the public. Until then, electric utilities were not about to move voluntarily.

During the current shift in economic normality, all the social and economic models of accountability and authority have been impoverished. Just about every significant benchmark in the electric utilities industry has now become a candidate for reappraisal. Hence, probabilities of future problems and their various causes cannot be extracted from the historical record of the electric utilities industry because of the volatility in the underlying measure.

Recommendations:

What can we do about a danger we can sense but do not comprehend?

We need to think ahead and we need to do it now. We need to recognize that such problems will happen unless something is done to prevent them from happening. For the sake of Washington state's future electric utility reliability, we must develop a means for paying attention to cases of security risk and reliability uncertainty that is neither reactionary nor complaisant. There is a sizable literature in psychology, sociology, and economics documenting individual and institutional assessments of risk. We know, for instance, that people tend to overestimate low probability events, such as the chance of being struck by lightning or being attacked by a shark, and to underestimate risks of high probability events such as the chance of dying from heart disease or being killed in an automobile accident. Indeed, this effect is borne out further in the behavior of society at large in terms of the frequent overreaction to either small, but highly publicized risks or to newly identified risks. In the face of a changing regulatory environment, what we do not know right now is what constitutes a low probability event, and what constitutes a high probability event.

• **What Can We Do?** We can start by collecting data and evidence from every industry that has deregulated in the past twenty five years: Airlines, trucking, railroads, telecommunications, cable television, brokerage services, banking, savings and loan institutions, and the petroleum and the natural gas industries. Each of these industries experienced its transition problems in slightly different ways and different institutions evolved in the various industries. Some problems were solved while others were exacerbated. What do their stories imply for future deregulation of the state's electricity grid? The electric utility industry can glean some valuable lessons from these other situations to predict and assess the effects of deregulation on its own structure and organization and to find guidance for its own policies toward energy network deregulation.

• **What Should We Pay Attention To?** We recommend that close attention by paid to how the social and economic consequences of deregulation prompted or effected security and reliability issues in other industries. By so doing, we can garner greater clarity for coping with concrete situations such as employee violence, customer dissatisfaction, sabotage, etc., in the electric utility industry.

• **Developing Analytical Models.** Once we have collected some general data from these other industries, then security and reliability models can be developed through the study of their historical and political experience and by taking into account the specifics of each situation.

• **For The Purpose of Prediction, We Need To Learn How To Think Outside The Box.** As controversial as this may seem, we suggest that the dominant approaches followed in the industry not be relied upon for measuring future levels of risk and reliability. As far as security for the electric utility industry is concerned, the quest for risk reduction will require other types of non-traditional probes: fault tree analysis, casualty data assessment, tetrad constructions, the production of instructive video tapes, the generation of imaginary accident scenarios, and a careful examination of what other industries typically went through as they implemented deregulation. To deal with a worst-case scenario for example, requires detailed study of the anatomy of security episodes both inside and outside the electric utilities industry.

In the meantime, it is reasonable for customers and the public to begin asking, "During this time of transition, will the power grid be sufficiently protected by regulators and the electric utilities to supply a constant level of service to customers throughout the state of Washington? What guarantees will customers have?

Hurlbut, Roy

940932

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Dear Mr. McLellan:

Enclosed are my responses to the questions in Part 2: Review of Specific Regulatory Mechanisms.

Thank you for the opportunity to comment on this very important issue.

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(EXAMINING REGULATION OF ELECTRIC UTILITIES)
(IN THE FACE OF CHANGE)
(IN THE ELECTRIC INDUSTRY)

DOCKET NO. UE-940932
SECOND PHASE COMMENTS
REVIEW OF SPECIFIC REGULATORY MECHANISMS

COMMENT OF
ROY B. HURLBUT

B. Part 2: Review of Specific Regulatory Mechanisms

B-1. Should the Commission retain its requirement in WAC 480-100-251 for utilities to prepare and submit least-cost resource plans?

Yes, least cost planning, when implemented, works to the benefit of the consumer.

B-2. What changes would you recommend be made to the details of the least-cost planning rule? Why?

Wheeling cost for each power option under consideration.

Under proposed new FERC rules, all utilities will be required to make a filing with FERC laying out terms and prices for transmitting electricity across their lines. (Source: Wall Street Journal) In my opinion, this requirement should be required by WAC 480-100-251.

B-3. Should the Commission retain its requirement in WAC 480-170 for utilities to solicit competitive bids for new resources?

Yes.

B-4. What changes would you recommend be made to the details for the competitive bidding rule? Why?

Review options from most economical to most expensive, and stack options from most to economical to most expensive.

This is done to select the most economical option. Review economical selected option for environment, regulatory, social and reliability considerations.

B-5. What cost-effectiveness test should the Commission use for the evaluation of conservation resources? Why?

Anticipated cost of pollution abatement additions to existing plants during the planning period: Each project should be evaluated as to:

A. Name, size, and location of plant;

B. Capital cost associated with the addition;

C. Operating and maintenance costs associated with the addition;

D. Incremental pollution abatement associated with project;

E. Schedule of construction.

B-6. Should the Commission consider external costs and benefits in its evaluation of investments in renewal and other resources? Why, or why not? If so, how would you recommend this be done?

The exigencies of modern planning require a through knowledge of external, as well as internal, energy resources which are available to the State of Washington.

B-7. Should the Commission modify its procedures and process for reviewing and establishing the prudence of utility investment in new electricity resources? In an industry marked by an increasing number of market transactions (including purchases and sales of power and energy related services), should prudence review be make more concurrent with transactions? What role would the least-cost plan and bidding process play in these reviews? Describe your recommendations in detail and explain why any changes would constitute an improvement.

The Commission should continue its prudent review of electric resources additions. This examination should be done concurrent with transactions. The State of Washington should require the use of least-cost planning in order to insure the best possible pricing to the consumers. Least-cost planning should be a continuing process by the Utility and the W.U.& T. Commission.

The following details are needed for each least cost plan.

"For LCP to earn its spurs it may have to be carried out on a geographic scale coincident with the size of the power market - the interconnected group of utilities located within economic transmission distance." (The Electricity Journal, Investing in Efficiency. August/September 1988.)

HOW IS LEAST COST PLANNING DONE?

- o USUALLY FOCUSED ON MAJOR COST COMPONENTS
- o QUANTIFY MAGNITUDE OF FUTURE DEMAND
- o IDENTIFY ALL OPTIONS FOR MEETING FUTURE DEMAND
  - SUPPLY SIDE
    - * GAS
    - * OIL
    - * COAL
    - * NUCLEAR
    - * HYDRO
    - * PURCHASES FROM THIRD PARTY
  - DEMAND SIDE
    - * CONSERVATION
    - * LOAD MANAGEMENT
    - * COGENERATION
- o COMPARE OPTIONS FINANCIALLY
- o STACK OPTIONS FROM CHEAPEST TO MOST EXPENSIVE
- o SELECT CHEAPEST OPTIONS FIRST UNTIL DEMAND IS MET
- o REVIEW CHEAPEST OPTION FOR ENVIRONMENT, REGULATORY, SOCIAL AND RELIABILITY CONSIDERATIONS
- o DEVELOP STRATEGY TO IMPLEMENT PLAN

B-8. Should the Commission adopt the integrated resource planning standard proposed and defined in EPACT Section 111 (see attachment C for proposed standard and definition)?

Yes. This can best be done on a macro basis by coordination the Western Systems Coordinating Council load flow studies with the regional requirements. These studies should be for various peaks, i.e., heavy winter/heavy summer. (See attached.)

B-9. Should the Commission adopt the standard pertaining to utility investment in conservation and demand management proposed in EPACT Section 111 (See attachment C for proposed standard)?

There is no simple rule which can be developed to address this situation. Some conservation could be required by a government agency which would not be economical for the utility. In general, the EPACT Section 111 part 8 is satisfactory.

B-10. Should the Commission adopt the standard pertaining to energy efficiency in power generation as proposed in EPACT Section 111 (see attachment C for proposed standard)?

The addition of the following incentives:

A. Safety Problems

B. Reliability

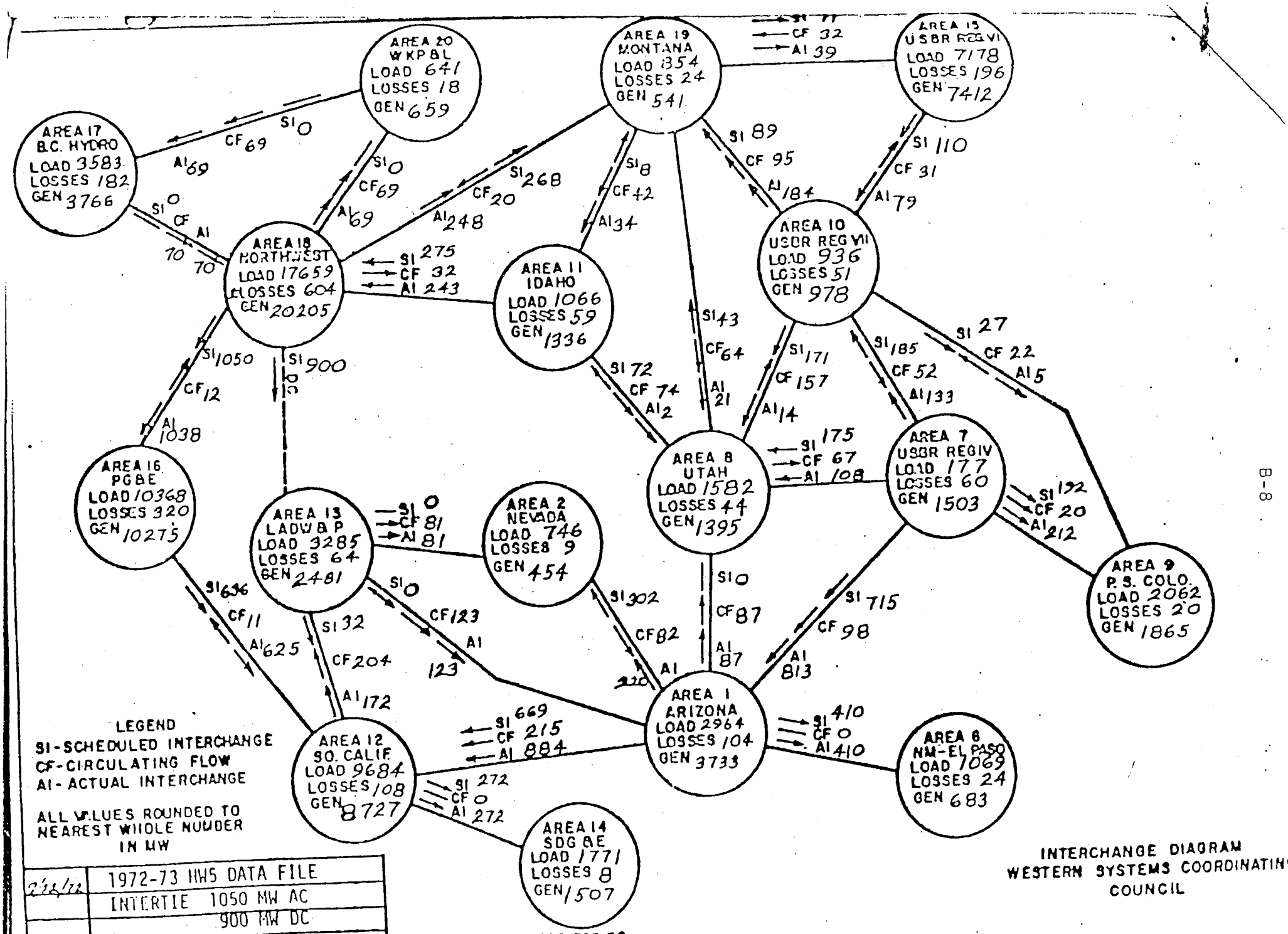
C. Pollution Control Equipment

D. Efficiency of fuel utilization.

These incentives should be added to EPACT Section 111 Subsection nine.

B-11. Have we asked the right questions? Are there any other inquiries we should undertake?

The Commission should be looking to future implementation of retail wheeling. This kind of competition would lower rates to the consumer.


AREA 20
WKP&L
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GEN 659
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MONTANA
LOAD 1354
LOSSES 24
GEN 541
AREA 15
USBR REG VI
LOAD 7178
LOSSES 196
GEN 7412
AREA 17
B.C. HYDRO
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LOSSES 182
GEN 3766
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NORTHWEST
LOAD 17659
LOSSES 604
GEN 20205
AREA 11
IDAHO
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GEN 1336
AREA 10
USBR REG VII
LOAD 936
LOSSES 51
GEN 978
AREA 16
PG&E
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GEN 10275
AREA 13
LADWP
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LOSSES 64
GEN 2481
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NEVADA
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GEN 454
AREA 8
UTAH
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GEN 1395
AREA 7
USBR REG IV
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GEN 1503
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GEN 1865
AREA 12
SO. CALIF
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LOSSES 108
GEN 8727
AREA 1
ARIZONA
LOAD 2964
LOSSES 104
GEN 3733
AREA 6
NM-EL PASO
LOAD 1069
LOSSES 24
GEN 683
AREA 14
SDG&E
LOAD 1771
LOSSES 8
GEN 1507
SI 0 CF 69 AI 69
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SI 268 CF 20 AI 248
SI 8 CF 42 AI 34
SI 89 CF 95 AI 184
SI 110 CF 31 AI 79
SI 0 CF 70 AI 70
SI 275 CF 32 AI 243
SI 1050 CF 12 AI 1038
SI 900
SI 72 CF 74 AI 2
SI 43 CF 64 AI 21
SI 171 CF 157 AI 14
SI 185 CF 52 AI 133
SI 27 CF 22 AI 5
SI 175 CF 67 AI 108
SI 192 CF 20 AI 212
SI 0 CF 81 AI 81
SI 636 CF 11 AI 625
SI 32 CF 204 AI 172
SI 0 CF 123 AI 123
SI 302 CF 82 AI 220
SI 0 CF 87 AI 87
SI 715 CF 98 AI 813
SI 669 CF 215 AI 884
SI 272 CF 0 AI 272
SI 410 CF 0 AI 410
LEGEND
SI - SCHEDULED INTERCHANGE
CF - CIRCULATING FLOW
AI - ACTUAL INTERCHANGE
ALL VALUES ROUNDED TO NEAREST WHOLE NUMBER IN MW
2/25/72
1972-73 HW5 DATA FILE
INTERTIE 1050 MW AC
900 MW DC
DATE
DESCRIPTION
*INCLUDES LOSSES FOR DC LINE REPRESENTATION
INTERCHANGE DIAGRAM
WESTERN SYSTEMS COORDINATING COUNCIL

NW Conservation Act Coalition

Northwest
Conservation
Act
Coalition

April 28, 1995

Mr. Steve McLellan, Secretary
Washington Utilities and Transportation Commission
1300 South Evergreen Park Drive S.W.
Olympia, Washington 98504-7250

RE: DOCKET NO. UE-940932

Dear Mr. McLellan:

Please accept the enclosed as NCAC's response to the Commission's invitation to comment on the initial round of comments in Docket UE-940932. We have provided ten copies of our response along with an electronic version in .TXT format.

We look forward to the ongoing discussion of how regulation should respond to change in the electric industry.

Respectfully,

David DeBusk

enclosures

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Response of the Northwest Conservation Act Coalition to Initial Comments in WUTC Docket UE-940932:

Examining Regulation of Electric Utilities in the Face of Change in the Electric Industry April 28, 1995

The Northwest Conservation Act Coalition (NCAC) appreciates this opportunity to comment on the initial responses to the Commission's Notice of Inquiry on Change in the Electric Industry. Much thought went into the many sets of filed comments. We were impressed both by the breadth of groups and individuals that chose to respond and by the several areas on which a "critical mass" of complementary views has formed.

Of course, there were numerous issues on which opinions diverged widely. We believe those would be better addressed in a workshop setting than through written comments. The following points, if not universally shared, do find much common support among a broad cross section of respondents.

REGULATING IN THE PUBLIC INTEREST

While the preponderance of comments suggested various changes to current regulatory practice, most of those suggestions were grounded in the principle that regulation -- and markets, to the extent they can work appropriately and efficiently -- need to promote important public policy outcomes. Additionally, the majority of commenters agreed that this investigation needs to begin with a clear statement of the desired outcomes.

"The Commission is correct in saying, in the introduction of the NOI, that a competitive marketplace is not the only objective of public oversight of electric utilities" (AWEA, p. 7). "Restructuring must proceed from a set of established principles" (WSACAA, p. 1). "The Commission should continue to focus on ensuring that rates are fair, just and reasonable, and that utilities pursue resource policies which fully consider long-run economic and environmental costs" (Public Counsel, p. 1). "In terms of conservation, 'resource stewardship' and other important policy considerations (e.g., assisting low income customers save energy, the inclusion of externalities to more fully account for the environmental impact of resource decisions, etc.) must be maintained" (O'Neill, p. 6). *The Washington State Energy Office tied together these themes in its vision of:* "[U]niversal access to safe, reliable, lowest cost, equitably allocated energy for Washington citizens" (WSEO, p. 1).

"If price reductions are the primary goal [of utility deregulation], the Commission should have agreement on the size of benefits that are necessary to justify the transition costs associated with competitive markets. If price decreases primarily benefit one class of customers, and utility social and DSM programs are sacrificed to achieve them, is an average retail price reduction of 10% sufficient to justify deregulation?" (Warwick, p. 8).

These underlying concerns transcend the particularities of industry structure: "...statutory public policy goals and objectives still apply to the industry, whether its structure is effectively competitive, monopolistic, or somewhere in between" (Public Counsel, p. 5). "...consistency with the State Energy Strategy should be a major factor in examining any alternative regulatory mechanism" (WSEO, p. 36).

A. Conservation

While nearly every party acknowledged the societal value of conservation, many questioned the extent to which it would be realized in a free market environment. Beyond insisting that conservation not fall off the map, various commenters explored alternative means of ensuring that adequate resources remain focused on the acquisition of cost-effective savings.

"Conservation and renewable resource goals should not be sacrificed to 'competition'" (Public Counsel, p. 2). "There is not necessarily any incentive for end-use efficiency and DSM, in part because deregulation tends to shorten the time horizon for investment decisions" (WSACAA, p. 5). "We know from high retail cost jurisdictions that customers do not implement most cost effective measures on their own, for many reasons, including split incentives (buyer/builder or landlord/tenant), inequitable access to capital, transaction costs, and poor information" (NPPC, p. 5). "Although conservation is of value to society generally and is very valuable to those who conserve, conservation measures themselves have no 'stand-alone' value as a resource to a utility in a competitive environment" (Puget Power, p. 6).

"...the region should not lose sight of its long term values...conservation is one of the lowest cost means of achieving those values" (Seattle City Light, p. 3). 'Two factors point to conservation. We don't need any more carbon dioxide and we would rather not pay the increasingly expensive cost for new energy resources" (Puget Shareholders, p. 5). "DSM is the State's number one priority resource and every effort needs to be made to ensure that all cost effective resources are acquired" (WSEO, p. 34). "We suggest that, in order to make competition fair, all generators be assessed a dollar-for-dollar match with the utilities for conservation programs based on kilowatt hours" (IBEW, p. 4).

B. Renewables

"Open competition may jeopardize the development of renewable resources to the extent these resources do not represent the monetarily least cost alternative. A free market will not recognize externalities used in selection of generation options unless they are either somehow internalized by all parties or directly regulated" (Puget Power, p. 6).

"Renewable resources are a high level priority and mechanisms such as 'set-asides' and 'safe harbors' should be explored in order to further their development" (NW Environmental Advocates, p. 1). "Whether or not the Commission acts specifically to reform the industry, the Commission should devise clear goals and procedures for utility acquisition of renewable resources" (AWEA, p. 3).

C. Access to Basic Energy Services

"Energy, specifically electric energy, has come to be an essential public good for most aspects of human endeavor. Electric energy needs to be available to all Washington's citizens in amounts at least sufficient to meet basic need and to promote a sound economy" (WSEO, p. 6). "Electrical power is an essential thread in the fabric of modern life. Besides lighting and refrigeration, many low-income people use it for water heating and cooking" (WSACAA, p. 1). "As the most captive of customers, low-income households are hardest hit by rate increases and least able to take advantage of choices, such as conservation measures, that are open to more fortunate customers" (WSACAA, p. 2).

D. Environmental Protection

"...it may be more difficult to accomplish this [internalize the social cost of environmental degradation] in a competitive environment, as competitive non-utility generators will tend to avoid internalizing these environmental costs in attempts to be the lower cost power supplier" (Public Counsel, pp. 5-6). "We believe consideration of externalities to be a useful planning tool which can allow policy discussions to be focused around

environmental values and their impact upon resource selection, capacity and timing in combination with other policy criteria such as utility costs, rate impacts, etc." (Seattle City Light, p. 3). "A carbon dioxide adder is needed so that carbon dioxide is taken into account in the planning process" (Greenhouse Action, p. 1).

E. Regional Cooperation

"Over the years, utilities have developed cooperative relationships with one another that have facilitated planning for the benefit of all customers. Utilities have shared results of research and development, engaged in joint construction, and provided emergency backup for each other. Retail wheeling would damage relations between electric utilities, pitting utilities against each other in a battle for customers" (IBEW, p. 3). "While most of the benefits of POOLCO are already being achieved in this region, any move to retail wheeling or retail access would diminish these benefits. If individual generating plants are dispatched to meet individual load requirements, we risk both economic and environmental costs" (Public Counsel, p. 27).

INTERPLAY BETWEEN REGULATION AND MARKETS

One of the key themes in the NOI has to do with striking a balance between regulatory and market approaches. The following comments generally acknowledge the value of both, and affirm their complementary nature.

"...the Commission would ill serve the public if it relinquished regulatory authority and relied on unsubstantiated 'market forces' (Public Counsel, p. 8). "A better framework...is to distinguish between the *determination* and *implementation* of policy. A goal setting approach relies on regulators (or other policy makers) to prescribe the policy goal, and relies on the market to implement and achieve the policy goal in the most cost-effective way" (AWEA, p. 10). "Regulation has advantages in achieving the following: protecting the interest of monopoly customers in access to electricity; pursuing public interests in conservation, renewable energy resources, and environmental; providing benefits of electricity to low income and remote customers; stable, affordable electric rates; a reliable, coordinated electrical system; and the use of utility services as an economic development tool" (Warwick, p. 17).

"Markets may also undervalue key factors (such as equity, environmental protection, comfort, long term cost, or reliability) or fail to anticipate long term risks or trends" (NPPC, p. 4). "WSEO strongly believes in a long-term perspective, for two reasons. First, a long-term perspective promotes the inter-temporal equity element of our vision. Second, a long-term perspective is the only way to compare capital-intensive resources with low-capital, high operating cost resources" (WSEO, p. 41). "Unfettered competition could have the effect of creating temporal inequities, as well as increasing long-term costs in order to reduce short-term rates. Regulatory or other mechanisms could be put into place that would mitigate the potential tendency of competition to focus on short-term over long-term profits" (WSEO, p. 13). "Societal benefit is not what competition is about, unless we make it a necessary factor in the equation" (WSACAA, p. 5).

"[Deferring regulatory oversight to market forces] is comparable to saying that a family does not need to budget its money because the money will be spent in a competitive market...Whether there is one grocery store or a hundred, it is the consumers who must make the choices that best reflect their own preferences and needs" (Public Counsel, p. 43).

Even in sectors where regulation has attempted to hand off to market forces, the results have not in every case eased the regulatory burden. "As the number of participants and the

diversity of their interests have grown, so too has grown the complexity and contentiousness of regulatory proceedings..." (PGT, p. 4). *In the electric sector, regulation is further complicated by the growing emphasis on wholesale transactions, and the proper allocation of the resulting benefits.* "A very serious problem arises if low cost resources previously used to supply captive customers in Washington are re-allocated to serve unregulated or out of state sales and the revenue is somehow placed below the line, while newer higher cost resources are acquired to serve Washington customers. The Commission should consider requiring Commission approval of all contractual sales off the regulated system with a term of 1 year or longer" (Public Counsel, p. 27). "...we question whether any utility, public or private, which has amortized and paid for the facilities they 'own' with ratepayer dollars (whether generation, transmission or distribution), can transfer those assets, or the benefits of those assets, to other customers, let alone to shareholders; particularly at their own volition (WSACAA, p. 4).

A. Validity of Competition in Wholesale Markets

Significant empirical questions exist around the issues of whether wholesale markets have become fully competitive. Many of the commenters believe that more reforms need to occur before robust competition can take place in bulk power markets.

"Even in the spot market, economically efficient outcomes may be constrained by the actions of participants who can play off their dominance in transmission facilities" (Public Counsel, p. 6). "The dual role of the utility as competitor and decision-maker seriously impedes wholesale competition and creates a need for complex regulatory oversight" (AWEA, p. 2). "Thus the wholesale market is not really a competitive market and therefore transactions in that market by a regulated utility are not to be ignored by regulators who are concerned about retail end users" (Public Counsel, p. 48).

Some parties believe that formal de-integration of presently-integrated utility functions is necessary to produce a level playing field. "To the extent that the Commission does not require even a partial restructuring of generation, transmission and distribution ownership, it will have to regulate all transactions even more substantially to prevent unfair competition and cross-subsidization on the part of vertically integrated 'competitors'" (American Forest and Paper, p. 5). "The worst of all worlds for ratepayers is a deregulated monopoly" (American Forest and Paper, p. 10).

While many parties recognize the increasing activity in bulk power markets, many question whether the immediate causes and effects are reliable indicators of longer-term trends. "If the competition is driven by short term considerations or market advantages, there is no justification for facilitating unfair competition or uneconomic bypass that harms the customers of regulated utilities or increases society's overall bill for electric services" (NPPC, p. 22). "Competition among public utilities, private utilities, and BPA using short term surpluses may occur...but this may not be an enduring problem or one that regulation should facilitate" (NPPC, p. 2). "Simple comparisons between the cost of raw power from gas-fired generators to the complex delivered product sold by regulated utilities are deceptive" (Public Counsel, p. 1).

Competition structured solely around price is unlikely to yield a societally efficient outcome, given that certain environmental and other societal costs remain outside of the financial calculus. "In a competitive market, the objectives of profit maximization and cost minimization are aligned" (AWEA, p. 5). *This is a key disconnect between market theory and present realities of the electric industry.* "Any market that ignores the quality of the products sold is clearly not in the public interest" (NW Environmental Advocates, p. 1).

B. Direct Access

The NOI addressed head-on the question of whether changes occurring at the wholesale level should be extended to retail markets (e.g., through retail wheeling). Most responses to this question entailed significant caveats and preconditions for fairness and efficiency.

"It should first be shown that retail access offers benefits to Washington customers, whether they are large industrial customers, commercial customers, or residential customers...There is no compelling reason for the Commission to propose retail access if a significant market opportunity or overall societal benefits cannot be shown" (NPPC, p.11). "Not only is it possible that retail wheeling will bring no additional economic benefits beyond those gained through wholesale competition, it may in fact reduce economic efficiency because the aggregated transaction costs of consumers and marketers could overwhelm any additional benefits gained over wholesale competition...Retail wheeling is more likely to result in cost-shifting and advertising wars than greater economic efficiency" (AWEA, p. 12).

"Simply initiating competition at the retail level, without taking any other measures, would most certainly result in benefits and detriments being allocated inequitably among customers" (Puget Power, p. 4). "Arguably, if transition policies fully account for stranded benefits, there will be no impetus at all for retail wheeling, which would confirm the view that the purpose of retail wheeling is for some to avoid their fair share of responsibilities" (AWEA, p. 12). "We have not seen any demonstration that these so-called "alternatives" are more than attempts by large customers to avoid their fair share of fixed costs" (Public Counsel, p. 13). "...it seems that one of the greatest forces behind restructuring is the push by industrial customers to garner the lion's share of the benefits for themselves" (WSACAA, p. 2).

"The campaign [for retail wheeling] cannot take advantage of national enthusiasm for 'less regulation,' since it conspicuously requires new and continuing regulatory intervention" (NRDC, p. 3). "...the retail electricity market, which this and other state regulatory commissions still regulate, has not and will not, absent state commission action, become a competitive and/or unbundled energy services market" (O'Neill, p. 5). "Retail wheeling encourages utilities to ignore making investments that will lower utility costs and environmental impacts over the long run" (IBEW, p. 4). "The net benefits to all customers of retail access policy are unsubstantiated and the risks and disadvantages are high" (Public Counsel, p. 13).

C. Treatment of Stranded Costs

"The commission should consider actions that preclude or prevent uneconomic bypass, which results when customers are able to purchase power for less than existing rates but more than marginal cost of service" (NPPC, p. 10). "The existence of economic alternatives assumes that the market rate of the alternative, plus any wheeling and distribution cost, are less than the utility's embedded cost for bundled service" (Public Counsel, p. 13). "Stranded investment costs should not be shifted to captive ratepayers either directly when customers bypass, or through favorable rate treatment of customers who threaten to leave" (Public Counsel, p. 18).

"If stranded investment costs are spread only among "core" utility customers remaining on a utility's system, there could be large increases in both core customer rates and utility ASC" (BPA, p. 5). "PacifiCorp believes that stranded investment should be borne by all interconnected parties, regardless of whether they are served by their traditional utility" (PacifiCorp, p. 11).

POLICY QUESTIONS

A. Least-Cost Planning

The NOI asks whether changing conditions in the electric industry warrant dispensing of integrated resource planning. Many commenters see the value of IRP as continuing or increasing, given a more complex and uncertain range of possible futures.

"Without IRP, incentives to promote short-run benefits at the expense of long-run benefits could be nearly irresistible" (WSEO, p. 27). "Integrated resource planning is a proven means of balancing the short-term and the long-term while incorporating environmental and other 'social' goals. The danger in the new, more competitive market place is for short term cost goals to dominate" (Seattle City Light, p. 2). "Public Counsel strongly supports the Commissions' least-cost planning efforts and believes they have been a major improvement to the quality of utility planning as well as regulatory oversight...We believe the result is lower costs for consumers, greater environmental quality, and even better financial returns for utility stockholders" (Public Counsel, p. 41).

"Least cost planning is, in fact, essential to the challenges of balancing market and non-market considerations (e.g., environmental costs) in a more competitive environment" (NPPC., p. 7). "The Commission's least-cost planning requirement should be retained and strengthened" (AWEA, p. 8). "We reject the notion that IRP is a command and control process that is the antithesis of competition" (O'Neill, p. 8). "Indeed, we believe that strengthening IRP principles would achieve many of the results sought by those suggesting the IRP should be abolished" (WSEO, p. 27). "Least-cost resource plans serve the public interest and should be retained" (Puget Shareholders, p. 2).

"Effective long-term planning does not become obsolete in a world of increased competition. In fact, we would argue that without effective and strategic long-term planning, electric utilities, whether they are investor-owned or consumer-owned, will fail in a more competitive world" (O'Neill, p. 3). "It is precisely the comprehensive analysis through the IRP process of not just the cost of resources but their value which permits utilities to sort through the myriad of options which the wholesale market presents" (Seattle City Light, p. 2). "Under any proposals that are focused on the short-term, there may be insufficient lead time to develop, permit and build base load and intermediate capacity in order to have it on line when needed. In that event, Washington could become dependent on expensive-to-run, but quicker-to-build, peaking capacity" (American Forest and Paper, p. 15).

"Ideally, the regional planning efforts of the Northwest Power Planning Council would be tied more directly to the activities of all utilities -- private and public -- selling power in the Pacific Northwest" (Chehalis Power, p. 2). "The siting process would have to be reformed to maintain control over the type of electric generation facilities that are built (this may be desirable in any case, especially in light of speculative building)" (AWEA, p. 15). "In light of changes in the wholesale market and reduction in the flexibility of the hydro system, displacement and capacity issues require greater attention...as well as the value of saved kWh and extra-regional markets" (NPPC, p. 14).

"We believe that least cost planning has improved the quality of utility decision making and that, without it, progress in improving competition among resources, efficiency of electricity use, and development of more environmentally benign resources would not have occurred" (NPPC, p. 3). "Getting the wrong resource at a good price is not an improvement over choosing the right resource" (Public Counsel, p. 43). "The current IRP process in Washington accommodates quite well competitive pressures by being a 'generic' plan, rather than a list of specific resources that a utility plans to acquire" (WSEO, p. 40).

In light of the demonstrated benefits of IRP, certain commenters recommended that IRP considerations be expanded and strengthened. "We believe that approval [of a utility's least cost plan] means more than the minimal acknowledgment process currently practiced by the Commission, but less than a blanket approval of acquisition of specific resources that are included in the IRP" (WSEO, p. 31). "[Currently] acceptance of a plan...means virtually nothing" (Public Counsel, p. 44).

"Least-cost integrated resource planning may need to be reconsidered or expanded so that utilities methodically analyze the potential of distributed generation, storage, and local DSM along with central generation (and storage) and T&D to find the most cost-effective mix of supply and demand-side resources and storage" (WSEO, p. 20). "Franchised T&D companies are economically justified for the purposes of aggregating consumer purchases, coordinating and planning the electricity system, and facilitating the diversification of the overall resource portfolio" (AWEA, p. 7).

"If there are benefits in acquiring generation in advance of service territory need, then the benefits apply equally to acquiring conservation in advance of resource need" (NPPC, p. 14). "Considering only incremental resources invites game playing where, by acquiring new resources just before an RFP is issued, a utility is always surplus at the time a plan or a competitive bid solicitation is issued and hence can claim no 'need' for power" (WSEO, 40).

"Integrated resource planning (IRP) complements competition...In order to accommodate the world of increasing competition and regional connectivity, IRP should reflect 'real world' resource acquisition issues -- that is, opportunities for wholesale transactions, relationships among transmission, distribution and resource planning; and strategic considerations" (WSEO, p. 4). "In addition to opportunities for wholesale purchases, opportunities for sale in the wholesale market is becoming an increasingly important source of revenues to the regulated utilities in this state. These transactions have the potential both to harm and to benefit customers and citizens. If a utility sells low cost resources at the wholesale market and retains high cost resources, one might argue that retail customers will be the losers" (WSEO, p. 28).

B. Competitive Bidding

"Planning should lead explicitly to bidding, and bidding should not be conducted absent an intent to actually acquire resources" (AWEA, p. 8). "If a utility wanted to bid its own project, a third party evaluation would be necessary to avoid the conflict of interest inherent in the utility judging its own projects against those of competitors" (AWEA, p. 6).

"To ensure a level playing field, the purchasing utility should identify a benchmark resource and a cost for that resource. If the utility rejects all bids, or if no bids satisfy the benchmark price, the utility should be obliged to build or acquire the identified resource at the stated cost" (Chehalis Power, p. 2). "An independent, impartial evaluator should be retained to review bids and oversee the bidding process...Issuing RFPs that 'test the waters' should not be allowed" (NIPC, p. 3).

"Any project, including qualifying facilities (QFs) larger than one megawatt, would have to meet the test of competition either through a formal RFP or through the informal market process" (PacifiCorp, p. 13).

C. Prudence/pre-approval

Despite increasing competition at the wholesale level, there was a broad recognition that regulatory mechanisms need to adapt to resource investments that are not well accommodated by current market measures.

Pre-approval...need not (and should not) provide a blank check. We would anticipate a continuing need to assess the efficiency with which the utility pursued agreed-upon objectives" (NPPC, p. 4). "A preapproval proceeding would grant approval for projects of a certain type (e.g., DSM or research and development) or above a certain size, and would constitute a finding that as of the date of the order, utility decisions that are contained in the record are deemed prudent" (WSEO, p. 31).

D. Protection Against Stranded Benefits

In terms of equity between core and non-core customers, broad agreement coalesced around the principle that restructuring should not entail shifting costs from relatively more independent customers to captive ones. Nor should important public policy priorities -- such as conservation, development of renewable resources, universal access to basic energy services, and research and development initiatives -- be eroded by increasing competition.

"...we are concerned that adequate provisions be made for certain current utility activities which increase short-term rates, but are intended to reduce long-term system costs. These expenditures include DSM programs, renewable resource "premiums," low-income energy programs, and research and development costs" (Public Counsel, p. 34).

"The answer [to the retail wheeling dilemma of cost shifting] lies in prohibiting cost shifts of this kind, either by rejecting retail wheeling outright or by recasting system costs as non-bypassable charges on utilities' distribution systems" (NRDC, p. 4). *Members of the financial community saw value in this approach, recommending* "[P]ossibly a surcharge on all Washington utility customers' bills to go into a pot to be paid to those companies that do implement conservation plans" (Ragen MacKenzie, p. 2).

E. Performance-Based Ratemaking

Performance-based ratemaking is like the hero of a thousand faces: it has radically different forms, and can lead to substantially different outcomes. Many of the comments on PBR referred back to guiding principles.

"Before looking at performance based ratemaking it is important to ask and answer what the nature of the problem is and what sort of performance should be rewarded. Current rules suggest that the utility should be rewarded for following a least cost plan" (NPPC, p. 11).

"Electricity is an essential good, and reliability must be maintained...Reductions in reliability should be by choice, not as an unintended consequence of competition" (Puget Power, p. 9). "WWP is aware that degradation of service quality has been an issue for regulators of telecommunications utilities as these companies have moved toward alternative forms of regulation" (WWP, p. 7). "Reduction in service and postponement of necessary preventive maintenance programs could also be a result of a reduction in force...there is a point at which employment cuts threaten quality, and indeed continuity, of electric service" (IBEW, p. 7).

"A focus on each transaction, on its own, may result in a higher cost portfolio, on average, because there is only downside exposure (e.g., finding of imprudency) to a utility with no option for a benefit or "supra-prudency." Performance-based ratemaking would focus on portfolios rather than specific components" (WWP, p. 12).

"A PBR mechanism can be devised under any of these scenarios that will modify any of the outcomes of the scenario for individual elements of this vision. One of our recommendations for this NOI is to examine alternative PBRs and how they might be devised to foster specific goals and to avoid undesirable results" (WSEO, p. 24).

Conclusion

Again, we appreciate the opportunity to comment on these important issues before the Commission. NCAC hopes that this amalgam of comments will help to focus the ongoing dialogue on certain key issues, with a sense of the diverse support they share. We are encouraged by the caliber of responses submitted to date, and look forward to pursuing these issues further.

NW Environmental Advocates

7

NORTHWEST ENVIRONMENTAL ADVOCATES

Columbia/Willamette
RIVERWATCH
133 S.W. 2nd Ave. #302
Portland, OR 97204

April 28, 1995

Steven McLellan
Commission Secretary
WUTC
PO BOX 47250
Olympia, WA 98504-7250

Dear Mr McLellan:

Enclosed are one original, ten copies and a floppy disk, (file formatted in Wordperfect for Windows) of our comments in UE-940932.

Sincerely

Eugene Rosolie

Eugene Rosolie

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

UE-949032

EXAMINING REGULATION OF ELECTRIC UTILITIES IN THE FACE OF CHANGE IN THE ELECTRIC INDUSTRY

NORTHWEST ENVIRONMENTAL ADVOCATES REPLY COMMENTS

APRIL 28, 1995

"...A sustainable society will go beyond the *warms* of capitalism and socialism. The challenge of inventing a new *ism* that values individual liberty and community, equity, the integrity of the ecosystem, and participation and accountability is an exciting one, and one whose time has come."

Stephen Viederman
Ecological Economic, 8 (1993)

Northwest Environmental Advocates (NWEA) appreciates this opportunity granted by the Commission to respond to the many comments in the above captioned proceeding. One comes away from reading a number of the comments with the impression that if we just do x,y and z we will have a perfectly function system. NWEA believes that all participants in this proceeding should agree that all markets have imperfections and the only truly competitive markets exist only in economic textbooks. As stated clearly by Paul L. Joskow:

> Regulation, deregulation, competition, and various combinations of them are not good or bad in the abstract...They are all imperfect...[1]

We should however, attempt to agree on those attributes that the commission should strive to achieve. This suggestion is similar to one made by the Public Counsel when they stated that the Commission should "identify what effective competition in the electricity industry would look like."[2]

Given the comments we have seen, we believe that the Commission does need to set some guidelines for any changes it will make. We would suggest as a starting point the following:

- new markets must be capable of producing a competitive outcomes that eliminate all opportunities for price discrimination and predation;
- strategies of incumbent firms must be inconsequential in impact their on the viability of competition;
- markets should minimize the cost of production in the long run; and
- monopoly focal points in residual monopoly markets must be neutralized.[3]

Based on our impression from a number of comments by various parties, we believe it important to briefly focus on at least two of the above points. First is the strategy of incumbent firms, in this case the private utilities. The Commission should not be worrying about how to protect and save the incumbent utility companies. Rather the Commission's focus should make sure that the market works and that the ratepayers are protected. Second, in a truly competitive market the producer or seller bears the risk. Unfortunately, many of the comments give the impression that the buyers, and just the small commercial and residential ones at that, should bear the risk. Clearly some commentors want their cake and want eat it to.

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[1] Joskow, Paul L., *Foreword to The Economics of Regulation, by Alfred E. Kahn, September, 1987.*

[2] Initial Comments of the Public Counsel Section Washington Attorney General's Office, February 17, 1995, p. 9.

[3] Trebing, Harry M., "Apologetics of Deregulation in Energy and Telecommunications: An Institutionalist Assessment," *Journal of Economic Issues*, Vol. XX No. 3, September 1986, p. 613.

In a footnote, the Public Counsel raises the question of monopsony power. We would agree that monopsony power is currently a problem in the utility industry, especially as it effects the development of renewable resources. Although there are many willing sellers, from natural gas plants developers to wind plant developers, there is only one buyer, the utility. It is clear from the comments in this proceeding and other venues that the utilities only interest currently is in buying the resource with the lowest short term price. This barrier can be, and must be, removed. Through the development of **choice for all customers**, the Commission could truly create a competitive market with many sellers and buyers.

Many commentors did talk about choice, but in most cases they meant choice for large industrial customers. **All ratepayers should have choices.** In almost every activity in this country consumers are allowed to make their own decision about what to purchase. Somehow when it come to supplying electricity the consumer is viewed as a helpless child and therefore mommy and daddy, the regulators and utilities, must decide for them. Of course the large industrial customers are grown up now, so they can make their own decisions. The rest of us must remain in our high-chairs and continue to be spoon-feed. NWEA would submit to this Commission that the residential ratepayers outgrew their high-chairs a long time ago. Recall that it was residential ratepayers who stopped the nuclear fiasco in the Northwest from Trojan to WPPSS. They did it inspite of resistance from regulators, utilities and industrial customers.

This discussion leads us to an issue that many commentors ignored, renewable resources. It is important that the Commission not make any changes that would discriminate against renewables. Therefore, we are suggesting that **the Commission require utilities under its jurisdiction to develop a green tariff.** With a green tariff individual ratepayers would be able to choose their generating resource.[4]

Ten years ago green businesses and products barely existed if at all. Today they are flourishing. Why? Because consumers were given a choice. When a market does not supply what the consumer demands its a market failure which needs to be corrected. Correcting such market failures is the proper role of government intervention. There are renewable energy developers waiting for the barriers to be removed to the resident or small commercial markets. This market correction can happen and must happen if we are to begin developing an environmentally sustainable energy future.

Reading the comments, we came to realize there was a lack of discussion about existing generating resources and that there is a need for environmental dispatch of all resources. We believe this to be especially important since a number of utilities in the Northwest are now purchasing power from coal, nuclear, gas and oil plants in the Southwest. **The limits put on the IRP process to account only environmental externalities from new resources, is hampering the move to a sustainable energy future.** Without a requirement that negative externalities be applied to all resources, existing and new, utilities will continue to have

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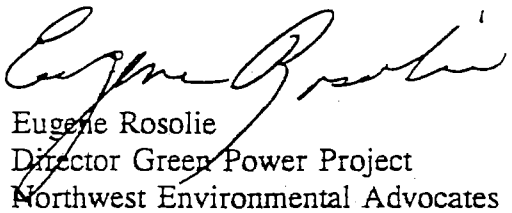
[4] We merely offer the concept at this point and believe that at some point in this process the details can be discussed in greater depth.

incentives to pollute. The evidence is clear, **all resources need to be included in the IRP.**[5] A perfect example is the case of the Trojan Nuclear Power Plant which Portland General Electric closed precisely because this existing resource was included in its least cost plan that showed that it wasn't the least cost option. If we are going to have social costing it must include both new and existing generating facilities and those costs must be included in the rates.

We appreciate this opportunity to comment and look forward to further participation in this inquiry.

Respectfully submitted,



Eugene Rosolie
Director Green Power Project
Northwest Environmental Advocates

[5] See "An Analysis of Alternative Approaches to Implementing Social Costing of Electricity in Maryland," by Karen L. Palmer, Alan J. Krupnick, Hadi Dowlatabadi, and Stuart Siegel, Discussion Paper (94-39), Resources For the Future, Washington, DC, 1994.

Opportunity Council

the Opportunity Council

a human service agency

April 28, 1995

Mr. Steve McLellan,
Commission Secretary
Washington Utilities and Transportation Commission
P.O. Box 47250
Olympia, WA 98504-7250

Dear Mr. McLellan,

Thank you very much for the opportunity to comment on the comments submitted in response to the NOI: Examining regulation of Electric Utilities in the Face of Change in the Electric Industry; Docket No. UE-940932. We are very interested in these comments and the proceedings that follow and hope very much to be part of the workshops that ensue.

At this time, however, we are not able to submit any cogent written response to the comments offered by others, except perhaps to question once again how much competition truly exists, even on a wholesale level. We would also note that it is very difficult to determine what is competition and what is consolidation, given the complex corporate structure of utilities, subsidiaries, affiliates, holding companies, etc. This all simply reinforces our belief that the key questions to be asked are:

1. Does the public benefit from this change or model of change?
2. What are those benefits and to whom do they flow?
3. How is equity maintained across customer classes?

We look forward to notice regarding the upcoming workshops and the opportunity to participate in them.

Respectfully,

Chuck Eberdt, Manager
The WSACAA Energy Project

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PacifiCorp

Portland, Oregon 97232
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PACIFICORP
PACIFIC POWER UTAH POWER

April 27, 1995

Steve McClellan, Commission Secretary
Washington Utilities and Transportation Commission
1300 South Evergreen Park Drive, SW
Olympia, WA 98504-7250

Dear Mr. McClellan:

Enclosed are the original, 10 copies and a WordPerfect version on floppy disk of PacifiCorp's reply comments in the Notice Of Inquiry "Examining Regulation of Electric Utilities in the Face of Change in the Electric Industry", Docket No. UE-940932.

Very truly yours,

Anne E. Eakin

Anne E. Eakin
Assistant Vice President
Regulation

Enclosures

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PACIFICORP'S REPLY COMMENTS TO WASHINGTON UTILITIES & TRANSPORTATION COMMISSION NOTICE OF INQUIRY (NOI)

Examining Regulation of Electric Utilities in the Face of Change in the Electric Industry

Docket No. UE-940932

April 1995

PACIFICORP'S REPLY COMMENTS TO WASHINGTON UTILITIES & TRANSPORTATION COMMISSION NOTICE OF INQUIRY (NOI)

Examining Regulation of Electric Utilities in the Face of Change in the Electric Industry

PacifiCorp again commends the WUTC for initiating this NOI. Dennis Steinberg, Senior Vice President, in a speech recently presented at the Electric Utility Regulatory Restructuring Conference, stressed the importance of reviewing and restructuring current regulation to the Company by stating "I think regulators must be effective players, and what's more the success of my company depends on our regulators taking an active and effective role."

PacifiCorp feels that the number of respondents and the breadth of their comments lend further credence to the importance of the issue. There were several key areas of the responses that merit further comment by the Company.

Is competition here?

While some respondents may believe that "the sky is not falling" the Company believes that competition is indeed here and is heating up. Currently 70 power marketers have registered with FERC and 15 additional companies have applications that are pending with FERC. The Company feels that BPA's comments that "FERC documents also show that Enron and Louis Dreyfus Electric Power, Inc., have taken quarterly losses in order to gain a foothold in the market" are representative of the current market and strongly indicate that competition is here and that the competition will be fierce. The Company urges the Commission to take this issue very seriously.

Alternate forms of regulation

There appears to be a general consensus among the commenters that traditional cost-based regulation will not serve the customers' interests in a more competitive environment. Some commenters expressed concern that the lack of traditional regulation will result in safety issues, service quality issues and unfair price burdens on certain classes of customers. The Company believes that a properly structured alternate form of regulation can bring to the customers the benefits derived from a competitive market; enhanced efficiencies, low prices, quality service, tailored product choices and more. Under any alternate regulation proposal, PacifiCorp recognizes the need to demonstrate that customers will be better off than under traditional regulation. The Company realizes the burden of proof is its own and is prepared to undertake it.

Retail wheeling

The Company does not fear retail competition. Competition is always a two edged sword, presenting both opportunities and challenges. The Company is willing to step up to the challenge and feels that it can be successful in a competitive environment. The Industrial Customers of Northwest Utilities note that "Customers depart from electric utilities on a continual basis. Some switch to other fuels, some can self generate, others move out of the state or region, or simply cease to exist." These are examples of how utilities already compete at the retail level. Many respondents indicated that "Retail wheeling is bad public policy" or that it is "a model doomed for failure". PacifiCorp believes that the truth is that retail competition already exists and will

accelerate as customer choices grow.

Disaggregation

There appears to be a strong consensus that a physical disaggregation of the generation, transmission and distribution assets will be required to attain many of the benefits of a competitive environment. Certainly FERC has indicated with its recent "Notice of Proposed Rulemaking on Comparable Transmission Service, Stranded Investment Recovery and Real Time Information Networks" that owners of transmission will be held liable to provide service to any requesting entity under the same conditions that it provides service to itself. This essentially disaggregates the transmission function from the generation and distribution function. Transmission simply becomes a common carrier. While the Company does not necessarily believe that a physical disaggregation is required, it agrees that this is an issue that deserves further discussion.

Demand side programs, renewable projects, "social programs"

There appears to be an acknowledgement among the respondents that the playing field is not level so long as only certain of the participants are required to meet "socially beneficial" requirements. Among the suggestions for dealing with this issue are a "line charge" and a change in the Utility Tax. PacifiCorp agrees that some means that assures that all participants in the energy market have the same social responsibilities is required. This does not mean that DSM, renewable projects or other social programs will be abandoned under a more competitive environment. Many of these programs will continue to make business sense in terms of their ability to provide low cost resources, resource portfolio diversity and enhanced customer service. For those programs that do not meet the business test but are deemed socially desirable, alternate funding sources that rely on contributions from all participants in the market should be explored.

Integrated Resource Planning (IRP)

Many of the parties responding stressed the need for a more extensive IRP process. They felt the Commission should approve rather than simply acknowledge the plan. Some felt the Commission should review and pre-approve each planned resource acquisition, a "rolling prudence review". PacifiCorp feels that this approach is inconsistent with a more competitive environment and taken to an extreme could place the Company at a severe disadvantage to its non-regulated competitors. Review and pre-approval of individual resource acquisitions would limit the Company's ability to respond to changes in the market. In the past the Commission has indicated an inability and unwillingness to attempt to bind future Commissions with a pre-approved resource acquisition.

A more extensive IRP process would expose the Company's strategic planning to its competitors. It would be like playing a game of poker in which the Company was obligated to lay its cards face up on the table while the competitors were free to keep their hands hidden and, indeed, to draw new cards until they had the Company's hand beat. The Company believes the market will impose its own prudency test. One respondent noted quite eloquently that "In the competitive market, regardless of the prudence of investment at the time the decision is made, an uneconomic resource or failed investment is simply not recoverable from the customers." The Company wholeheartedly agrees. Now is the time to maintain maximum flexibility in planning, not to implement more prescriptive rules.

IRP will need to change as the industry changes. Centralized planning and IRP are consistent with monopoly control of an industry. As the electric utility industry transitions from regulated monopolies to a competitive market the need for centralized planning decreases.

PacifiCorp believes a broadening of the definition of "least cost" can reflect changing market realities as competition increases. The interpretation of least cost by the Commission has led to an expectation that the utility will plan primarily for lowest total resource cost (TRC). TRC includes utility cost, customer costs for DSM, and non-energy benefits of DSM. Focusing planning on a TRC standard leads to higher levels of DSM and higher customer prices than would result if planning focused on utility costs and retail prices. Focusing on TRC does not adequately reflect the reality of customer choice. Customers make their decisions on perceived costs and benefits to their own businesses. Broadening the definition of "least cost" to incorporate customer concerns with the prices they face will increase the usefulness of IRP to both the utility and regulators. Allowing for consideration of other measures that may, in the future, better reflect the growing importance of market prices will provide a way for IRP to adapt to the changing utility environment.

Similarly, focusing on average customer bills does not adequately reflect the reality of customer choice. Each individual customer looks at their own situation and makes a decision about where to purchase their electricity based on who can provide them with the most choice, best service, and lowest price. Thus, non-participating customer may see no benefit from DSM activity that lowers average customer bills. PacifiCorp believes that to be successful, planning must be consistent with market realities.

How IRP may change depends in part on how much of the business remains subject to regulation. IRP can be tailored to the part of the business that remains regulated. For example, if extensive restructuring occurs and retail customers have access to competitive suppliers, or if the industry or a company is functionally disaggregated, then IRP can focus on the need to provide retail service efficiently and at low cost to the utility's noncompetitive customers. It would then review the balance between demand-side and supply-side services, the balance between short-term and long-term agreements with its suppliers, and the balance between price impacts and benefits.

Unfortunately, IRP as currently defined occurs in a two-year cycle. This results in a relatively static process, which does not lend itself to the rapidly changing competitive market. Actual analysis for an IRP occurs during only a couple months of each two-year cycle. During the rest of the time, the Company and the public advisory group develop the issues to address in the IRP, prepare and review all of the inputs, review the model, prepare and review the model outputs, develop and review the action plan, prepare and review the draft report, and prepare and review the final report. In the past, all resource acquisitions were utility-built and -owned with long lead times. Analyzing such decisions only once in each two-year period was reasonable. However, utilities now rely also on opportunities from the market. When resource opportunities arise outside of the narrow time phase, they cannot be included in that IRP cycle. They must wait for the next cycle. However utilities cannot wait to take action on opportunities that arise in the market. For this reason, a great deal of acquisition activity necessarily has to occur outside of, and in parallel with, the IRP process. The alternative is to have a continuous IRP analysis process that never gets to the action plan and report phase.

PacifiCorp also believes that it will be very difficult to plan more than ten years ahead because of market uncertainties. Competition is changing the industry and the environment in which PacifiCorp does its resource planning. The changes occurring in the electric industry suggest that all of today's assumptions are likely to be outdated within five to ten years. As competition increases, the customer base will change as will other pressures on the business.

The Company has carefully observed the natural gas industry, and the changes that have occurred during their deregulation and increasing competition. An open market has created radical shifts in supply and price forecasts in the natural gas industry. Today in that industry a two-year contract is considered to be long-term. A free market makes forecasting very difficult and unreliable the farther out in time it predicts.

Puget Power

PUGET SOUND POWER & LIGHT COMPANY

P.O. BOX 97034
BELLEVUE, WASHINGTON 98009-9734
(206) 454-6363

April 28, 1995

HAND-DELIVERED

Mr. Steve McLellan, Executive Secretary
Washington Utilities and
Transportation Commission
P.O. Box 47250
Olympia, Washington 98504-7250

Re: Docket No. UE-940932
Response to Notice of Inquiry

Dear Mr. McLellan:

We appreciate this opportunity to provide further comment on the Commission's Inquiry. In reviewing the comments submitted by the participants, we are encouraged by the degree of interest in this Inquiry, as well as the range and diversity of opinions expressed. However, nothing in those comments would lead us to recommend any divergence from the principles articulated in Puget's original comments. Consequently, we continue to direct the Commission's attention to the company's original response to the Inquiry.

Having reviewed all the comments submitted to date and considering the serious implications of potential structural changes in the industry, we believe four areas of more immediate concern should be emphasized.

Establishment of Policy Intent

The industry is clearly in a transitional stage. There are very serious consequences to an uncertain and unguided transition. Consequently, we believe that it is important for the Commission to formulate guiding principles which would establish the policy parameters for this transitional phase and narrow the scope of this Inquiry. A number of commenters, in addition to Puget, have recommended the development of such

principles and have offered proposed principles for the Commission's consideration. While a breadth of opinion has been expressed, continuation of unconstrained debate has diminishing returns.

Achievement of Environmental Goals

Many parties have expressed a strong interest in establishing a method by which national, regional, and state environmental goals can be achieved in certain possible future states of the industry. Puget shares this interest. For example, if utilities and IPP's are to develop regionally-preferred resources such as conservation and renewables, those developers must be indifferent to the current cost impacts of these more environmentally benign resources. Many parties -- and the Commission itself -- have noted that the Commission may not have sufficient authority to implement these goals, and a legislative initiative, such as a broad-based tax for renewables and conservation may be needed.

Commission Authority

As noted in the NOI, the Commission regulates less than one-half of the electricity service provided in the state of Washington. Consequently, we are concerned that this Inquiry alone cannot produce a comprehensive, integrated structure that provides appropriate controls and incentives for all participants in the provision of electricity service in the state. For example, while many commenters have expressed the opinion that IRP requirements should be maintained or strengthened in order to accomplish certain public policy goals, the application of this requirement to only investor-owned utilities regulated by the Commission results in a competitive disadvantage due to, among other things, the administrative burden imposed on those utilities as well as the consequences of public dissemination of proprietary information. The policy intentions surrounding IRP were clear at the time of the establishment of the rule. Policy intentions and the methods by which they are accomplished in the new environment should be revisited. Any benefits of continuation of IRP should be reevaluated in light of the disadvantages to companies which will require flexibility in a more competitive industry. We encourage the Commission, informed by this Inquiry, to pursue efforts with the state legislature to establish policies that are equitable for all participants in the electric industry in the state of Washington.

Flexibility

One clear message in many of the comments is that customer choice, and additional flexibility for utilities to meet customers needs, are essential elements for this industry today and in the future. Puget concurs with this view. We believe our customers now

have and will continue to have increased elements of choice in the electrical products and services that they receive. Flexibility, as described in the company's original response, is required to address customer needs regardless of the eventual state of the industry.

Puget appreciates the Commission's efforts in providing this continuing forum and for the opportunity to submit comments. Please consider these comments, along with our original comments, as an integrated response to the Commission's Inquiry to date. We look forward to continued participation in this Inquiry.

Sincerely,

PUGET SOUND POWER & LIGHT COMPANY

By: Sheila Manus Vortman

Sheila Manus Vortman
Senior Vice President Corporate and Regulatory Relations

Puget Power Shareholders

Puget Power Shareholders for Fairness

April 14, 1995

Mr. Steve McLellan, Commission Secretary
Washington Utilities and Transportation Commission
1300 Evergreen Park Dr. S.W.
P.O. Box 47250
Olympia, WA 98504-7250

Dear Secretary:

Subject: Comments on Responses to NOTICE OF INQUIRY (NOI) - Docket No. UE-940932 (Examining Regulation of Electric Utilities in the Face of Change in the Electric Industry) - dated Dec. 16, 1994.

After reading the responses to the subject NOI our position pretty well remains as it was submitted. However, we do feel that it would be in order to comment briefly on the response of Public Counsel.

We accept Public Counsel's definition of a competitive marketplace as one where there are many sellers and many buyers.

Therefore, we are dismayed to read that, rather than facilitating competition, Public Counsel would use regulation to set barriers to the emergence of a competitive marketplace (" 'Cherry Picking' by non-utility power marketers should be prevented"). Indeed, cherry picking usually doesn't last long in a free market. Other cherry pickers soon move in and act to underprice the initial cherry picker. It isn't too long before the buyers are enjoying a competitive price, all without the benefit of regulation.

Perhaps it is in Public Counsel's approach to prudence reviews where it is particularly nervous. Public Counsel fears "dangers lurk" immediately after a significant business decision when "ramifications of the decision may not yet be apparent." Public Counsel argues that "resources of Public Counsel are best utilized when all of the issues are on the table, rather than considered in a piecemeal fashion."

Unfortunately, business people must make decisions to meet current needs and take risks in the present. They do not have the benefit of hindsight.

Because of Public Counsel's misgivings about being able to perform a prudence review according to the pace of business, it may be well for Public Counsel to step back and admit that its main qualification is in legal matters. Let the Commission handle the

prudence reviews. Public Counsel can serve a productive role by making sure that the reviews take place and that there are no violations of state law.

We shall be looking forward to the next step with regard to the subject Notice of Inquiry.

Yours very truly,

/s/	/s/	/s/
Mr. Robert Hettinger 18653 NE 146th Way Woodinville, WA 98072	Ms. Yvonne Kelly 20823 NE 150th St. Woodinville, WA 98072	Dr. Allan G. Osborne 5829 NE 198th Place Seattle, WA 98155
/s/	/s/	/s/
Mr. Harold Sherrill 1121 - 244th SW, Unit 43 Bothell, WA 98021	Mr. John H. Wolch 12526 SE 25th Place Bellevue, WA 98005	Mr. Fred A. Zelonka 4236 88th Ave. SE Mercer Island, WA 98040

Seattle City Light

Seattle City Light

Gary Zarker, Superintendent
Norman B. Rice, Mayor

April 28, 1995

Steve McLellan
Commission Secretary
Washington Utilities and Transportation Commission
1300 S. Evergreen Park Dr. S.W.
P.O. Box 47250
Olympia, Washington 98504-7250

Dear Mr. McLellan:

Docket No. UE-940932

On February 17, 1995, Seattle City Light responded to the Commission's Notice of Inquiry (NOI) on "Examining Regulation of Electric Utilities in the Face of Change in the Electric Industry" by addressing four specific NOI questions which were of particular concern to us.

Those four specific questions were:

(1) Question A-3, "Does the Commission have sufficient authority to fashion regulatory tools that can adapt to meeting the challenge of a changing industry?"

(2) Question B-1, "Should the Commission retain its requirement in WAC 480-100-251 for utilities to prepare and submit least-cost resource plans?"

(3) Question B-5, "What cost-effectiveness test should the commission use for evaluation of conservation resources? Why?"

(4) Question B-6, "Should the Commission consider external costs and benefits in its evaluation of investments in renewable and other resources? Why or why not? If so how would you recommend this be done?"

The reason that we chose those four questions in particular was that they represent what Seattle considers to be critical and central issues for this region which have to do with the role of public power in the Northwest and the values of Seattle as reflected in the Northwest Electric Power Planning and Conservation Act.

We have reviewed the 37 written comments which the Commission received in response to its Notice of Inquiry (NOI) and are pleased that, in large part, the respondents shared, if not the specifics, certainly the heart of our views. Specifically, most who commented believed, as we do, that the long term well being of the region should be paramount in any restructuring and that Integrated Resource Planning should play an integral part to help to ensure that decisions based on short-term pricing do not dominate our future. As well, many respondents expressed concern for the environment and the continued role of conservation and renewables in a deregulated, competitive utility industry. A central theme of several respondents was that competition should be viewed as a means to achieve goals, not an end unto itself. Seattle strongly supports that view and believes that prior to further deregulation basic principles and ground rules must be established which set a stage for future decisions which further regional values, not sacrifice them. We, like many other respondents, believe that competition and our regional values can co-exist. But, we must proceed deliberately to ensure that the appropriate public interest framework is established.

An issue which we did not address in our February letter but would like to address now is stranded investments. We believe that where long-term cost-effective investments were entered into by utilities and the region in good faith; the means must be found to ensure that those investment costs are recoverable and are not bypassed to the detriment of utilities and their remaining customers. Others have suggested exit fees, or volume charges as means of ensuring the equitable distribution of costs associated with investments whose price is not competitive in the near term environment. Whatever the mechanism, we must ensure that all customers are treated fairly and that competition does not become a "ruse for shifting costs to captive rate-payers" as articulated by the Washington Attorney General's Office, Public Counsel Section.

We appreciate the Commissions deliberate approach to considering those issues and the opportunity you have afforded for input. Seattle City Light is keenly aware of the far reaching effects of deregulation on the industry and the concomitant impacts on all utilities, both public and private, and our customers.

Both forms of utility have a major stake in the outcome of such a process. We must work together as a State and a Region to ensure that the appropriate structure is provide for competition so as to truly serve the interests of all of our customers.

Very Truly Yours,

Gary Zarker
Superintendent

GZ:dp

cc: Norm Rice, Mayor
Anne Levinson, Deputy Mayor
Bruce Brooks, Deputy Mayor
Cyril Juanitas, Deputy Chief of Staff
Jane Noland, Councilmember
Steve Johnson, OIR
Bennie Barnes, OIR
Paul Reiter, OMP

SESCO

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

NOTICE OF INQUIRY: Examining Regulation of Electric Utilities in the Face of Change in the Electric Industry	DOCKET NO. UE-940932 PRELIMINARY REPLY COMMENTS AND REQUEST OF SESCO, INC. FOR 7-DAY EXTENSION OF TIME TO FILE REPLY COMMENTS

SESCO's counsel has been called to Idaho on a family matter and cannot complete the reply comments due on April 28. Consequently, SESCO requests a 7-day extension of time for the filing of its reply comments.

In the meantime, SESCO offers preliminarily copies of its extensive testimony on electric utility industry restructuring before the California Public Utilities Commission.

Dated: April 27, 1995

Respectfully Submitted,

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BEFORE THE
CALIFORNIA PUBLIC UTILITIES COMMISSION

Order Instituting Rulemaking on the Commission's Proposed Policies Governing Restructuring California's Electric Services Industry and Reforming Regulation	R.94-04-031
Order Instituting Investigation on the Commission's Proposed Policies Governing Restructuring California's Electric Services Industry and Reforming Regulation.	I.94-04-032

COMMENTS OF SESCO, INC.

ON

BALANCING PUBLIC POLICY OBJECTIVES

IN THE COMPETITIVE ENVIRONMENT

June 24, 1994

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SESCO is a minority-owned corporation with more experience in the field of residential "pay-for-performance" conservation projects than any firm in the country. Some of SESCO's recent projects include:

- **The Central Maine Power Co. (CMP) Residential Power Partners Project.** At 10 average megawatts and 30,000 whole house retrofits, this is the largest residential performance contract undertaken. SESCO has treated more than 15,000 residences to date.

- **The New York State Electric & Gas Co. (NYSEG) Free Power Project.** This project has begun treating 10,000 houses in various service areas in New York.

- **The Rockland Conservation Project.** In this 5,000-residence project for Orange & Rockland Utilities, which began in early 1990, payments are based upon measured long term savings (a 25-year measurement period).

- **Portland General Electric Co. (PGE) Free Power Project.** SESCO will begin treating 5,000 lower-income houses in and around Salem, Oregon, in the spring of 1993.

SESCO is negotiating a contract with San Diego Gas & Electric Co. (SDG&E) for a 1994-96 project representing about 80% of the total funding made available to SDG&E for its DSM bidding pilot. SESCO is also one of the finalists for DSM bidding pilot contracts with Southern California Gas Co. (SoCalGas) and Southern California Edison Co. (SCE); negotiations are underway.

SESCO provides comprehensive energy efficiency treatments (insulation, weatherstripping, water heating and lighting improvements), all at no cost to the owner or occupant of the house or apartment and at prices fall below the avoided costs of the contracting utilities.

Due to resource limits, SESCO's comments are limited to:

1. Methods for ensuring that cost-effective DSM resources are not overlooked.

2. Methods for ensuring that low-income weatherization efforts are continued undiminished in scope but increased in cost-effectiveness.

Whether the Commission adopts a "direct access" system or requires the California investor-owned utilities (IOUs) to divest their generation assets and operate as transmission/distribution companies, the Commission should ensure that ratepayers have the opportunity to receive competitive and cost-effective DSM services.

SESCO supports the Commission's intention to require all future DSM programs for Utility Service customers be implemented through competitive bidding:

> Finally, we expect and will require the utilities to subject to competitive solicitations all future demand-side management programs designed to serve those who remain utility service customers.

OIR R.94-04-031/OII I.94-04-032 ("Blue Book," April 20, 1994) p. 55. The efficiency of bidding has been demonstrated in the DSM pilot bids already underway and by bidding experiences elsewhere.

SESCO recommends that the CPUC move promptly to implement this competitive bidding requirement for DSM programs, with all savings to be paid on the basis of *ex post* measured savings pursuant to the CPUC measurement and evaluation protocols, as those are continuously developed and improved. The utilities would be welcome to participate in such competitive solicitations and to earn profits for their shareholders by pricing their DSM services below the prices offered by the ESCOs. The investor-owned utilities in Massachusetts are already required to participate in DSM competitive bidding in their own service areas; such participation is also allowed in New York and Washington.

Such DSM-only bidding would not, however, enable DSM to compete with supply resources. SESCO supports integrated (generation and conservation) competitive bidding and in many rounds of earlier comments and briefs in various CPUC proceedings has urged the Commission to proceed with integrated bidding, which has been successfully implemented in many states. We have urged the Commission to adopt all-source bidding, with utilities allowed to offer generation or DSM resources in their own solicitations, with the utility's profit on accepted and implemented projects equal to the bid price minus the project's actual cost to the utility. This would provide a level playing field for the utilities, for generators, and for ESCOs. The CPUC should require PG&E to proceed with the integrated bidding pilot, which PG&E has sought to postpone since the issuance of the Blue Book.

This "electric utility restructuring" docket has so far focused on competition on the supply side, without considering how DSM can compete with supply. Direct access, in essence, would allow power generators to compete with each other, with all generators having access to the utility billing system to charge

ratepayers the price of power, with no requirement that each customer put up as a deposit or investment an amount equal to the capital cost of the generation facilities serving the customer.[1] The Commission should also enable DSM providers to compete with power generators by allowing DSM providers equal access to the utility billing system, with no requirement that each customer pay up front the capital cost of the DSM equipment. ESCOs are willing to pay the capital cost of DSM investments, if they have a reliable means of charging the customer for the resulting energy savings over a period of time corresponding to the life of the investment. And, as utilities would meter the power provided to the customers by the power generators, the utilities could assist in measuring the DSM resources actually delivered to customers by means of the CPUC's *ex post* measurement and evaluation protocols. In essence, direct access would extend to DSM as well as to generation.

The efficiency benefits of large DSM programs operated through utilities should be recognized. SESCO has found that the cost of residential weatherization can be cut in half when implemented through a utility program providing improvements at no cost to the customer. Eliminating the need to collect money up front from the each individual consumer substantially reduces the actual cost of the program (cutting out most marketing, advertising, and costs associated with consumer financing) and allows economies of scale and efficient use of warehouses, trucks, and trained DSM personnel.

Market barriers to implementation of cost-effective DSM remain. Assume there were no utility DSM programs at all. Private-sector DSM firms ("ESCOs") would be able to implement only those DSM commercial or industrial projects with a very high TRC benefit/cost ratio, probably exceeding 3.0, because utility customers require a very short payback period in order to justify spending their money on DSM. Many CPUC decisions have recognized this.[2] For example, in

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[1] If a residential customer were required to make such a deposit, it would probably exceed $5000.

[2] Market barriers to implementation of cost-effective DSM are probably highest in the residential sector, where sellers of DSM services outside of utility programs must overcome consumer resistance based upon:

1. The substantial initial cost of most measures to the consumer (for weatherization, etc.);

2. The poor reputation of the "home repair" industry and those who solicit improvement work on residences.

Other market barriers inhibit ESCOs from pursuing residential programs on their own. For example, while a generator providing direct access power to a consumer can rely

the DSM competitive bidding RFP proceeding, the Commission concluded that any bid program with a simple payback period longer than 2 years would be accorded a Net-to-Gross Ratio (NTG) of 1.0, equivalent to zero "free riders." This is the same as concluding that zero customers would be willing to implement projects with paybacks longer than 2 years, equivalent to a TRC benefit/cost ratio of about 3.0.[3]

To overcome various market barriers to cost-effective DSM, the CPUC has authorized the utilities to use ratepayer funding to implement cost-effective DSM projects or programs. One small aspect of the utility DSM efforts to date has been CPUC-ordered DSM competitive bidding, which has shown there are dozens of ESCOs able and willing to implement DSM projects (and to be paid on the basis of *ex post* measured savings) at TRC benefit/cost ratios far exceeding 1.0. In Decision No. 93-11-067 and Decision No. 94-04-039, for example, the CPUC approved numerous bid projects for PG&E with TRC benefit/cost ratios ranging from 1.81 to 2.37 (nearly all above 2.0), with payments based upon *ex post* measured savings using methods "reasonably consistent with our adopted measurement and evaluation protocols." Decision No. 93-11-067, p. 20.

A simple direct access system for generation would not achieve these cost-effective savings. Assume that Industrial Customer obtains direct access at a generation price of 3 cents/kWh. The most economic generation resources will be committed to the first customers pursuing direct access; the price of such power will likely increase for the customers later able to avail themselves of direct access. Assume, then, that the residential class later has direct access but that the market

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upon being paid for the power provided (through the utility billing system), an ESCO that invests its own funds in residential DSM improvements has no comparable assurance of payment over time, as the dwelling owner may prove unable or unwilling to pay, and individual account collection costs are high.

It has been long and widely recognized that landlords are loathe to make DSM investments, because (1) the reduced utility bills directly benefit only the tenant and (2) the investment usually cannot be recouped in the market by means of higher rents for a nonobvious amenity (such as floor insulation or switchplate gaskets or most caulking and weatherstripping). Yet this market barrier remains in place.

[3] Putting this in perspective, assume that an electric utility had an avoided cost averaging a typical 3.5 cents/kWh (1994 present valued dollars at a conservative nominal 9.50% discount rate) and a retail rate of 8.0 cents/kWh. A program featuring measures with a 2-year payback (i.e., total cost of 16 cents per first year kWh) with a 15-year savings-weighted measure life would have a TRC benefit/cost ratio of 3.3 (exclusive of externalities or non-energy benefits). Thus, the Commission has recognized that it cannot rely upon the market alone to implement DSM projects with a payback period longer than 2 years (i.e., below a TRC benefit/cost ratio, in this example, of 3.3).

generation price for new direct access customers is then 5 cents/kWh. In the meantime, DSM at Industrial Customer's site costs 3.5 cents/kWh. Industrial Customer will have no economic incentive to implement the DSM, however, as it is paying only 3 cents/kWh for power. Thus, 3.5 cents/kWh DSM may be foregone, while generation resources costing 5 cents/kWh are built.

Thus, deliberate DSM programs are needed for Utility Service customers and perhaps even for Direct Access customers.

TARGETED RATEPAYER ASSISTANCE PROGRAMS

The assumption of the Commission's inquiries seems to be that such services are not authentic electric system resources. We differ. In particular, low-income weatherization can be implemented to provide a cost-effective resource.

Direct Assistance programs are coming to dominate utility spending in the residential sector. The table below, extracted from the 1994 program year data provided by the utilities in the CPUC proceeding on DSM shareholder incentives, shows utility planned DAP spending and benefit/cost ratios.

UTILITY	1994 DIRECT ASSISTANCE SPENDING*	TRC B/C RATIO			* Planned actual outlays may be higher, as it appears that some utilities are subtracting out substantial non-energy benefits in its calculation of incremental measure costs.
		Non-Mandatory	Mandatory	Total	
PG&E	$49.8 million	1.4	0.5	1.0	
SCE	$20.1 million	1.1	0.4	0.9	
SDG&E	$4.0 million	2.5	0.1	1.0	
SoCalGas	$52.1 million	0.3	0.3	0.3	

The California utilities have apparently concluded that the weatherization components of Direct Assistance programs are not and cannot be cost-effective. SESCO, however, has offered to implement low-income weatherization on a cost-effective basis (TRC benefit/cost ratio exceeding 1.0) in a bid recently submitted to PG&E (for gas and electricity savings) and intends to submit a cost-effective bid

later this year in the SoCalGas DAP bidding program, if SoCalGas allows payment on the basis of *ex post* measured savings of gas in accordance with the CPUC's adopted measurement and evaluation protocols.

One reason existing low-income weatherization programs are not cost-effective is because the CPUC provides no incentive for utilities to pursue such programs efficiently. Several utilities have insisted that low-income DAP programs are not cost-effective and cannot be made cost-effective. They have used this as a justification to insist that the related shareholder incentive/penalty should either be zero (completely divorced from program performance) or should be based upon dollars spent, not upon benefits delivered.

Under the "no incentive/penalty" and "performance adder" mechanisms, the utility is paid the full cost of the program, regardless of cost-effectiveness of the savings achieved, or (for "non-mandatory" measures) is paid an incentive based only upon the total budget dollars expended, regardless of the cost-effectiveness.

The CPUC and California utilities have long recognized a special obligation to provide conservation programs, especially weatherization assistance, for low-income residences. The purpose is to alleviate the burden of high energy bills among a group that can least afford them and to improve the energy efficiency of low-income housing. Although ratepayers have been asked to bear these costs, society as a whole appears to have accepted this burden as money well spent.

There is no disagreement that the utility DAP programs do not presently produce cost-effective savings; that fact is the utilities' rationale for leaving DAP programs out of the shared savings category for shareholder incentives.[4] Unfortunately, the people who are most harmed by this poor cost-effectiveness are the low-income customers themselves. Given the reasonable assumption that the typical utility has a limit on the dollars it will spend on low-income weatherization, the only way to increase the benefits received is to improve the cost-effectiveness of the dollars spent.

Improving the cost-effectiveness of the DAP programs has major "up-side" impacts by increasing the benefits delivered to low-income households and reducing the costs of DSM resources. It will also help protect against the "down-side" risk of reduced ratepayer funding. Disregarding the issue of cost-effectiveness may quickly undermine the support of the ratepayer population for low-income weatherization--especially if ratepayers believe it costs more than it is

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[4] For example, SoCalGas reported to the CPUC in February 1994 that its DAP program has an overall TRC benefit/cost ratio of 0.21 (without environmental adders) or 0.32 (with adders). SDG&E and SCE have also reported TRC benefit/cost ratios significantly below 1.0.

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REPLY COMMENTS OF SESCO, INC.

ON

BALANCING PUBLIC POLICY OBJECTIVES

IN THE COMPETITIVE ENVIRONMENT:

CALIFORNIA NEEDS MORE COMPETITION

(ROUND 2)

July 21, 1994

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SESCO is a minority-owned corporation with more experience in the field of residential "pay-for-performance" conservation projects than any firm in the country. Some of SESCO's recent projects are noted in the Comments of SESCO filed June 24, 1994. SESCO is one of the largest ESCOs of any type in the United States but is very small compared with the DSM division of any of the major California utilities.

SESCO provides comprehensive energy efficiency treatments (insulation, weatherstripping, water heating and lighting improvements), all at no cost to the owner or occupant of the house or apartment and at prices far below the avoided costs of the contracting utilities and far below the cost of alternative sources of power supply.

SESCO is paid only by the utility, at some fraction of its avoided costs for the saved energy and capacity, with payments trued up to *ex post* measured savings using protocols at least as stringent (and often far more stringent) than those required by the CPUC's *ex post* measurement protocols. This is precisely the same procedure used for independent power producers who are paid solely by the utility for each measured kWh delivered at some fraction of the utility's avoided costs.

Our reply comments here differ from our earlier comments in this round, as our comprehension of Direct Access and the potential benefits of restructuring increases. Our main message: Competition is good. It is very good. It is much better than the "command and control" that has been the hallmark of the current utility industry and regulation. But do not leave conservation out of the competition. We want to compete. The Commission's commitment to competition must focus on conservation as a competitive force, not just generation-side competition.

DSM is not a "customer value" or public relations adjunct to generation resources; it is an effective competitor against generators. Conservation providers (or "DSM aggregators") should be treated, as much as possible, the same as supply-side providers or aggregators.

Since our short comments cannot cover all aspects of this issue, we urge your record to incorporate the transcript of the California Energy Commission's workshop on ESCOs, conducted July 14, 1994, when it becomes available. The CEC commissioners, the utilities, and ESCOs from all sectors engaged in useful discussions there.

In California, DSM has been accorded a decidedly secondary role to the supply side. None of the huge BRPU auctions were open to DSM bidders. Instead, competitive "pay for performance" DSM companies have been limited to the extremely small DSM pilot bids, which in total have provided less than $75 million in available funding over a 3-year period. To date, the utilities have signed contracts committing only about $35 million of that amount. Assuming an overall TRC of 2.0 and a DSM typical utility load shape, the $75 million represents a total of roughly 30 MW for a period of around 10-15 years. This is dwarfed both by the BRPU auctions and by the utilities' spending on their internally designed and operated DSM programs.

In this context it is very important to distinguish between an ESCO and a contractor. An ESCO (energy services company) is a company that is responsible designing and implementing a DSM effort, and especially for the actual savings, the actual performance of the measures installed. An ESCO is in direct competition with the utility's internal DSM staff which is theoretically doing the same thing.

A contractor is a company that installs the improvements at the behest of another party. Contractors are often hired by the utility to implement the program and install the measures as directed by the utility. Contractors are also hired by ESCOs (including SESCO) for exactly the same thing: to install measures in accordance with the program designed by the ESCO. They are not held responsible for the savings or the appropriateness of the program design. Contractors are not competitors with utility DSM programs.

ESCOs, conversely, are competitors with generators, with utility DSM programs, and with each other. The California utilities are already aware of the competition potential. To our knowledge, not one of the California utilities have hired an ESCO to design and implement a single program, except under the direct and explicit compulsion of the Commission's DSM bidding pilot orders, with the possible exception of SCE's EnVest program, which excludes the entire residential sector, including apartments.

The CPUC has been focusing on competition on the supply side, while failing to even allow competition between DSM and supply or between ESCOs and utilities implementing DSM programs. We urge the Commission to allow competition among all generation and DSM providers.

I. FOR DIRECT ACCESS CUSTOMERS, DSM PROVIDERS NEED EQUAL TREATMENT WITH GENERATORS.

The CPUC Blue Book envisions "direct access" to customers by generators but not by ESCOs.[1] This is a fundamental flaw.

The CPUC's vision would allow generators to offer their services (electricity) to individual customers, using the utility transmission and distribution and, most important, **the utility billing system information.** Access to billing and consumption data (under an appropriate confidentiality agreement) is as important to independent conservation providers (ESCOs) as access to the transmission and distribution grid is to independent generation suppliers. Each system is a huge and crucial asset of the regulated entity (or of the ratepayers). The utility billing system provides:

1. Essential information to allow for the accurate and impartial measurement of energy savings at each facility.

2. Essential information for targeting and marketing supply and DSM services.

3. A very strong means to ensure that each customer pays for the services received. Nonpayment can lead to disconnection.

No generator could survive in providing electricity to customers without being able to use the utility billing system. All generators would require the means to discontinue services for nonpayment. Without using the utility billing system, a generator would have to require each customer to pay a large deposit, probably $1000 or more, to ensure against nonpayment. Also, many generators would benefit from billing system information. For example, a multi-year billing history on a residence can show whether the house has electric space heating or electric water heating. Generators offering "time-of-use" rates would seek to contact those customers with electric water heating loads that could be shifted to light load nightie hours.

ESCOs should be treated no differently than generators or than the utility DSM programs. Just as generators invest millions of dollars in power production

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[1] The CPUC uses the term "direct access" to refer to the customer's access to generators. We see it as the generators' direct access to the customer, using the utility billing system.

equipment, ESCOs invest millions of dollars in efficiency improvements. ESCOs cannot compete with generators without equal access to the utility billing system to (1) measure the savings results, (2) target customers for marketing and priority treatment, and (3) avoid customer nonpayment for the improvements made by the ESCO to the customer's premises.

If generators are provided a checkbox on the utility bill (for NucPower Co. or GreEnergy Co., etc.), then we want checkboxes for SESCO and other qualified ESCOs. Let the customer choose efficiency improvements instead of supply and reduce the customer's electricity/gas/water bills. ESCOs can offer guaranteed utility bill reductions but only if they can amortize the cost of their services on the customer's bill over a period of years not exceeding the savings-weighted life of the measures installed.

ESCOs need their own place on the customer bill. ESCOs cannot function as mere adjuncts to power suppliers, because ESCOs are strong competition for power suppliers. There is no reason to prevent the independent operation of ESCOs or to assume that generators would have any interest of offering DSM services as a "customer value" service.

II. FOR UTILITY SERVICE CUSTOMERS, DSM PROVIDERS NEED EQUAL TREATMENT WITH GENERATORS AND UTILITIES.

As pointed out at the July 1 hearing, only about 4% of California utility DSM budgets, funded by ratepayers, are available to ESCOs through competitive bid, and signed DSM bidding contracts amount to only about 2% of those DSM budgets. Thus, over 95% of ratepayer DSM funds are presently reserved for management and use only by the utilities.

The utilities are now spending well over $400 million per year on DSM programs. That is just outlays; it does not include their claims for DSM shareholder incentives, which for 1993 totalled $96.4 million (now under adjudication in the 1994 AEAP proceeding, where DRA has recommended $37.9 million). We believe that most of these funds are well spent. However, in contrast, the total size of the DSM bidding pilots ordered by the CPUC is only about $25 million per year and only for 3 years. Of that, the utilities have signed contracts for only about half, or $12 million per year.

The utilities may say that they sign lots of contracts with "ESCOs." In fact, they sign lots of contracts with "contractors" (including installers, retailers and

manufacturers) and other firms that do not take responsibility for the *ex post* measured savings from the measures installed. ESCOs want to compete on the basis of actual *ex post* measured savings, not just install measures regardless of what the actual savings turn out to be. ESCOs are not geared to "payment for piecework"; they want "payment for performance."

Some utility representatives urge the CPUC to avoid more bidding until the results of the DSM pilot bids are known. As of today, only a few of what will ultimately be 20 or so DSM pilot bidding contracted-for projects are underway, as 3 of the 4 utilities (all but PG&E) have not yet completed contracting for the DSM the CPUC has required through bidding. The "results" (*ex post* measured savings) for even the first year of installations will not be known until mid-1996 at the earliest. By then, the utilities at the current rate will have spent an additional $1 billion on DSM--with no competitive bidding whatever. And that does not include any shareholder incentives.

The Commission cannot wait for the *ex post* measured savings "results" of the DSM pilot bids--and need not do so. The ESCOs are putting their own money on the line at prices fixed by contract. If the *ex post* measured savings do not materialize, then the ESCOs will not get paid. The savings are guaranteed to be cost-effective, as payment is trued up to actual *ex post* measured savings. In contrast, the present CPUC system allows the utilities to charge the entire cost of their DSM programs to ratepayers in the year the funds are expended. If the programs do not work as projected, the utility does not have to give the money back (unless the program suffers near complete collapse).

The DSM pilot bidding process has shown that scores of ESCOs are willing to invest their own funds to implement DSM projects with TRC benefit/cost ratios averaging nearly 2.0, equal to 50% of the utility's stated avoided cost. In the current CPUC proceeding on DSM shareholder incentives, the utilities seek shareholder incentives equal to 30% of the net resource benefits on any program with a TRC benefit/cost ratio of at least 1.0. A TRC of 1.0 does not even get an ESCO to the door; the DSM bidding pilots showed that it takes a TRC of over 1.5 to get to the door and a TRC of about 2.0 to get a contract.

And all of these bidding procedures (except the PG&E bid) required the bidders to guarantee TRC benefit/cost ratios, on the basis of *ex post* measured savings, higher than those forecasted by the utility for its own efforts in the same sector on the basis of *ex ante* estimated savings. The ESCOs are required to maintain these higher TRC benefit/cost ratios, even after they incur significantly higher financing, security, and other burdens not required for utility DSM programs.

One example: ESCOs are required to use their own funds to provide the DSM treatments; they are not allowed to charge the full cost to ratepayers in the year of treatment.

And those ESCO TRC benefit/cost ratios **include** all of the ESCO profits and all of the projected utility shareholder incentives as well. The ESCOs implementing projects must then prove the achievement of *ex post* measured savings and in many cases actually post with the utility letters of credit or other security in the millions of dollars, guaranteeing that the expected savings will be achieved (or the security money will be kept by the utility).

Despite the higher standards required of ESCOs, we expect to implement quality projects--quality small projects. We and other ESCOs seek the opportunity to implement larger projects, if successful in competition with generators and utilities.

SESCO has appeared in numerous CPUC proceedings over the past 3 years advocating that all new resources, supply or DSM, be acquired through all-source competitive bidding. The CPUC has instead instituted a separate and unequal system that harshly penalizes DSM. While generators can compete in the huge BRPU auctions, ESCOs are limited to competing for less than 4% of the current utility DSM budgets. And ESCOs are not allowed to compete with the generators at all.

Why should the BRPU auctions be limited to generators? Why should the other 96% of DSM funding be reserved to the utilities? The CPUC already conducts a sort of DSM bidding but allows only the utilities to participate. Each year, the utilities file their plans for the following year's DSM programs, along with projected cost-effectiveness tables. In the year after the program year, the utilities return in the AEAP proceeding to seek shareholder incentives, to date based upon the assumed *ex ante* estimated savings. Thus, each utility presents a "bid" to the CPUC for DSM programs in its service area, which the CPUC in effect accepts on behalf of ratepayers. The problem is that the CPUC only allows the utility to bid. The DSM bidding pilots show that ESCOs could effectively compete with the utility DSM programs and with generators but at present are not allowed the opportunity.

III. COMPREHENSIVE RESIDENTIAL DSM IS MOST EFFICIENTLY IMPLEMENTED ON A MASS BASIS.

Some economic activity is more efficient if organized and paid for on a mass

basis, not on the basis of individual customer evaluation and payment. No utility asks each customer to buy wires and hire a contractor to string the wires to the house from the nearest utility pole, even though that particular function is not a "natural monopoly."

If the responsibility for organizing and paying for all or any portion of the cost of residential DSM is left with each individual customer, the cost can be quite high. Each customer would need to:

- become educated on the cost of various DSM alternatives
- contact a contractor (or the utility) for a house audit and accommodate the audit visit
- contact at least 2-3 contractors to examine the house and provide bids for the work and accommodate each contractor's visit
- analyze each contractor's bid and decide what work, if any, should be performed
- accommodate the selected contractor(s) visit(s) to perform the work
- accommodate the visit of the utility inspector
- accommodate contractor re-visits to correct problems identified by the inspector
- possibly arrange a bank loan or other means to pay for the work
- wait and see if the work done actually saves energy

Even then, since the contractor is not responsible for the ultimate *ex post* measured savings, the work performed may not be ideal. The contractor may well fail to install all cost-effective measures, may install measures that are not cost-effective, and may install measures incorrectly or use poor quality materials. Further, if the measures do not work in the first post-treatment year, the contractor does not return to correct any problems.

SESCO has learned that over half of the cost of residential weatherization programs can be eliminated if (1) the direct cost to the customer is eliminated and (2) the work is done by an ESCO paid on the basis of *ex post* measured savings.

This approach works particularly well in lower-income neighborhoods, as it is unlikely that families in which every adult works will have either the time or the money to pursue residential DSM on their own. It also works well on rental dwellings, where the landlord lacks interest in the utility bills of the renters. This approach is also superior in all neighborhoods, as it precludes the use of DSM funds for measures that are not cost-effective (such as replacement windows or electric heat pumps) that customers may otherwise wish to buy with financial help from the utility.

This approach works extremely well in low-income areas, as we pointed out in our opening comments. SESCO has offered to implement low-income weatherization on a cost-effective basis, even for SoCalGas, but none of the California utilities has yet allowed competitive bidding for direct assistance program funds on the basis of *ex post* measured savings. Instead, they hire contractors on a "pay for piecework" basis only and actively oppose efforts to allow "pay for performance" competition.

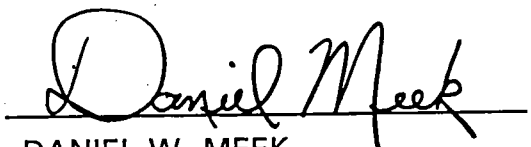
IV. CONCLUSION.

SESCO urges the CPUC to continue its work on reforming utility regulation, with emphasis on allowing full and fair competition among utilities, generators and ESCOs. Utility statements opposing all-source ("integrated" bidding) have included the conclusion that such competitive bidding would somehow be undesirable, because DSM is inherently more cost-effective than new supply. We believe that DSM *ex post* measured savings can be achieved by ESCOs at a cost below new generation and below the cost of existing utility DSM programs. We believe that allowing ESCOs to compete fully with generators and utilities will also reduce the cost of new generation and utility DSM programs.

Competition is good. California needs more competition. ESCOs can provide it, if given the chance.

Dated: July 21, 1994

Respectfully Submitted,



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ON

CUSTOMER CHOICE THROUGH DIRECT ACCESS: ENSURING THAT CUSTOMERS CAN CHOOSE *EFFICIENCY,* NOT JUST CONSUMPTION

(ROUND 4)

August 24, 1994

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SESCO is a minority-owned corporation with more experience in the field of residential "pay-for-performance" conservation projects than any firm in the country.

In August 1994, SESCO signed a contract with San Diego Gas & Electric Co. (SDG&E) to treat about 20,000 residences, which will be by far California's largest "pay for performance" residential DSM project and the first residential performance contract in the nation to include natural gas savings, projected at 9.8 million life-cycle therms (as well as 200+ million life-cycle kilowatt-hours), under a unique "tiered pricing" system to promote comprehensive treatments. SDG&E will purchase the measured savings for about 1.9 cents per kWh (1993 present valued dollars), equal to about 55% of SDG&E's avoided cost to produce the equivalent energy, producing a *ex post* measured savings TRC benefit/cost ratio 1.81.

SESCO is currently negotiating a similar contract with Southern California Gas Co. (SoCalGas) and Southern California Edison Co. (SCE), which will provide gas savings at 73% of SoCalGas's avoided cost and electric savings at 51% of SCE's avoided cost.

SESCO provides comprehensive energy efficiency treatments (insulation, weatherstripping, water heating and lighting improvements), all at no cost to the owner or occupant of the house or apartment and at prices far below the avoided costs of the contracting utilities and far below the cost of alternative sources of power supply. SESCO is paid only by the utility, at some fraction of the utility's avoided costs for the saved energy and capacity, with payments trued up to *ex post* measured savings using protocols at least as stringent than those required by the CPUC's *ex post* measurement protocols.

"Customer Choice through Direct Access" was addressed in the comments and reply comments filed by SESCO in round 2 of this proceeding, "Balancing Public Policy Objectives in the Competitive Environment." There, SESCO recommended providing more choices to customers by allowing direct access to energy service companies (ESCOs) as well as to independent generators.

The Commission should adopt a system to allow customers an efficient means to choose how best to meet their ultimate needs for space heating and cooling, water heating, lighting, and other end-uses for which the customer buys electricity or gas or both. Customers should be able to choose to buy cost-effective conservation, not just kilowatt-hours and therms.

I. CUSTOMER CHOICE UNDER THE EXISTING SYSTEM.

A. CUSTOMERS ON THEIR OWN.

The existing system provides residential customers with a menu of very limited choices for efficiently satisfying their needs for space heating and cooling, water heating, lighting, and other end-uses for which the customer buys electricity or gas or both from the utility. Many have commented on the transaction costs or "hassle factor" faced by the customer, particularly the residential customer, in implementing a conservation project. Even those customers who can take advantage of a utility residential weatherization program, each customer needs to:

- become educated on the cost of various DSM alternatives
- contact a contractor (or the utility) for a house audit and accommodate the audit visit, which may require taking time off of work
- contact a recommended minimum of 2-3 contractors to examine the house and provide bids for the work and accommodate each contractor's visit
- analyze each contractor's bid and decide what work, if any, should be performed
- possibly arrange a bank loan or other means to pay for the work
- accommodate the selected contractor(s) visit(s) to perform the work
- accommodate the visit of the utility inspector
- accommodate contractor re-visits to correct any problems identified by the inspector
- wait and see if the work done actually saves enough energy to be cost-effective

Even then, since neither the contractor nor the utility is accountable for the ultimate *ex post* measured savings, the work performed may not be ideal. The contractor may well fail to install all cost-effective measures, may install measures that are not cost-effective, and may install measures incorrectly or

use poor quality materials. Further, if the measures do not work in the first post-treatment year, the contractor does not return to correct any problems. Nor is the utility willing to provide a guarantee that the measures it recommended will produce the savings promised, or even that the customer or ratepayers will earn back their investments.

It is not surprising, then, that with such so-called experts refusing to ensure savings, residential customers are often unwilling to accept this risk and fail to act "rationally" by not implementing DSM measures that appear to be very cost-effective (according to the utility's experts). In fact, the transaction costs renders those measures not cost-effective to the individual homeowner or landlord. This applies to non-weatherization measures as well. For example, the CUSTOMER DECISION STUDY (July 22, 1994), prepared for SCE by Cambridge Systematics, Inc., apparently abandoned the effort to calculate a net-to-gross (free rider) ratio for compact fluorescent bulbs after determining that residential customers' behavior shows an annual discount rate of 294 percent.

SESCO has learned that often 50% or more of the total cost of residential weatherization programs can be eliminated if (1) the direct cost to the customer is eliminated and (2) the work is done by an expert ESCO paid on the basis of *ex post* measured savings. This approach works well in:

- lower-income neighborhoods, as it is unlikely that families in which every adult works will have either the time or the money to pursue residential DSM on their own

- rental dwellings, where the landlord lacks interest in the utility bills of the renters

- all neighborhoods, as it precludes the use of DSM funds for measures that are not cost-effective (such as replacement windows or electric heat pumps) that customers may otherwise be persuaded to buy

B. TYPICAL UTILITY DSM PROGRAMS.

Typical utility DSM programs do not address these large transaction costs. Instead, utility incentives or rebates attempt to reduce the apparent cost of the targeted measures, without reducing the transaction costs. This is a fundamental flaw that is overcome with the SESCO-type approach and with

the approaches implemented by most companies implementing "pay for performance" contracts resulting from competitive bidding.

And utility DSM programs do not offer customers any choice--other than the utility program. Utility programs channel ratepayer funds into only one method for attempting to achieve conservation--the one that the utility's experts have determined is the single best choice for all ratepayers. This is similar to a discount retailer's claim that "one size fits all" or Henry Ford's comment, "The customer can have any color he wants--as long as it's black." Utilities frequently tell us that they do not wish to confuse the customers by offering more than one residential weatherization program at a time, or even more than one program addressing any other type of DSM opportunity.

Unfortunately, the Commission has yet to see fit to allow ESCOs to compete with utilities for management of ratepayer funds currently dedicated to DSM. Only about 4% of California utility DSM budgets, funded by ratepayers, are available to ESCOs through competitive bid. Over 95% of ratepayer DSM funds are presently reserved for management and use only by the utilities. Failure to require implementation of DSM through performance-based competitive bidding will continue to inflate DSM costs, particularly in the residential sector.

We have earlier pointed out that low-income weatherization (Direct Assistance) programs now dominate utility spending in the residential sector, yet the utilities resist the implementation of "pay for performance" competitive bidding that would probably at least double the benefits to low-income customers per dollar spent. Current Direct Assistance program are implemented without any bidding or with "pay for piecework" bidding, in which contractors are not rewarded for actually achieving energy savings in the houses treated. With contractors paid merely on the basis of the number of measures installed or the number of households treated, the financial incentives defeat, rather than promote, cost-effective conservation. California utilities have continuously refused to allow competition to choose which type of program can best serve the needs of low-income customers.

II. CUSTOMER CHOICE UNDER A DIRECT ACCESS SYSTEM.

The direct access system envisioned by some commenters would lessen the ability of customers to choose the most efficient means to satisfy their end-use needs. But implementation of a direct access system that includes ESCOs in addition to independent generators could enhance customer choice.

The existing financial incentives to implement conservation would be reduced, should large portions of costs now reflected on the utility bill as energy charges (per kWh or per therm) be reallocated as fixed customer charges. Some comments appear to suggest that method to allow utilities to recover their "stranded investment" costs or even their entire transmission and distribution costs in a direct access system. Reducing energy charges while increasing inflexible customer charges will discourage an economically efficient customer choice to implement DSM.

Also discouraging to cost-effective conservation would be elimination of the current ERAM system, which seeks to decouple utility profits from the volume of energy sales. If CPUC decisions were to allow utilities to collect revenue on a per-unit-sold basis, with no true-up to actual sales, then utilities will again have a strong financial incentive to increase sales, whether or not that is cost-effective for ratepayers.

Our round 2 comments suggested:

> ESCOs should be treated no differently than generators or than the utility DSM programs. Just as generators invest millions of dollars in power production equipment, ESCOs invest millions of dollars in efficiency improvements. ESCOs cannot compete with generators without equal access to the utility billing system to (1) measure the savings results, (2) target customers for marketing and priority treatment, and (3) avoid customer nonpayment for the improvements made by the ESCO to the customer's premises.
>
> If generators are provided a checkbox on the utility bill (for NucPower Co. or GreEnergy Co., etc.), then we want checkboxes for SESCO and other qualified ESCOs. Let the customer choose efficiency improvements instead of supply and reduce the customer's electricity/gas/water bills. ESCOs can offer guaranteed utility bill reductions but only if they can amortize the cost of their services on the customer's bill over a period of years not exceeding the savings-weighted life of the measures installed.
>
> ESCOs need their own place on the customer bill. ESCOs cannot function as mere adjuncts to power suppliers, because ESCOs are strong competition for power suppliers. There is no reason to prevent the independent operation of ESCOs or to assume that generators would have any interest of offering DSM services as a "customer value" service.

With direct access to ESCOs through the utility billing system, even residential customers will likely have a multitude of DSM choices offered by numerous ESCOs. At present, however, there are not enough operating ESCOs in the residential sector to offer much choice. The reason is that the existing California DSM system has provided residential DSM contractors will no incentive to become "pay for performance" ESCOs. Why should a contractor now being paid on a piecework of per-measure-installed basis take on the risk of ensuring that its treatments actually save energy?

The Commission should assist contractors by providing them with financial incentives to become "pay for performance" ESCOs by immediately implementing the Blue Book recommendation that all future DSM programs for utility service customers be implemented through competitive bidding:

> Finally, we expect and will require the utilities to subject to competitive solicitations all future demand-side management programs designed to serve those who remain utility service customers.

OIR R.94-04-031/OII I.94-04-032 ("Blue Book," April 20, 1994) p. 55. If this system were implemented now, scores of ESCOs would be created, just as scores of independent power producers were created after the implementation of PURPA and the subsequent competitive bidding requirements on the supply side.

Even if customers are allowed direct access to ESCOs through the utility billing system, no ESCO can guarantee that every residence treated will save enough energy to reduce its utility bill. Year-to-year variations in residential energy use result from changes in occupancy, appliances, and habits. ESCOs treating large numbers of dwellings can and do, however, guarantee specific levels of energy savings from each group of homes treated.

Further, if an ESCO were to guarantee each residence that its utility bill would go down (even if it includes the cost of the treatment spread over its average expected lifetime), then the occupants would no longer have a financial incentive to use energy wisely, knowing that the ESCO will have to pay for all of their additional energy consumption.

Thus, the customer could choose to buy kWh and therms only or also to buy DSM offered by DSM providers (ESCOs and the utilities). The DSM providers could offer the customers a guarantee that each **group** of dwellings

treated will achieve a certain level of *ex post* measured energy savings, say 15% of pretreatment usage, depending upon the measures installed and techniques implemented. If the DSM provider were to fail to meet the required level of savings, it would be required to make a refund to the failing group of treated customers sufficient to achieve the guaranteed overall reduction in their aggregate utility bills.

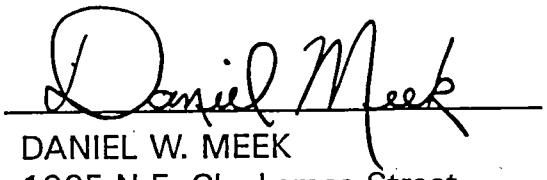
III. CONCLUSION.

SESCO urges the CPUC to continue its work on reforming utility regulation, with emphasis on allowing full and fair competition among utilities, generators **and ESCOs** and allowing customers effective means to choose DSM instead of merely kWh and therms. DSM *ex post* measured savings can be achieved by ESCOs at a cost below new generation and below the cost of existing utility DSM programs. Allowing ESCOs to compete fully with generators and utilities will also reduce the cost of new generation and utility DSM programs.

Customer choice is good. California needs more customer choice. ESCOs can provide it, if given the chance.

Dated: August 23, 1994

Respectfully Submitted,



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WA Industrial Committee for Fair Utility Rates

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MARK P. TRINCHERO

April 27, 1995

VIA FEDERAL EXPRESS

Mr. Steve McLellan
Commission Secretary
Washington Utilities &
Transportation Commission
1300 S. Evergreen Park Dr., S.W.
Olympia, WA 98504-7250

Re: WICFUR REPLY COMMENTS
Docket No. UE-940932
Our File No. 29446/23

Dear Mr. McLellan:

Enclosed for filing with the Commission in the above referenced docket is the Reply Comments of the Washington Industrial Committee for Fair Utility Rates. An additional 10 copies as well as a 3 1/2 inch diskette are also enclosed.

Sincerely,

DAVIS WRIGHT TREMAINE

Mark P. Trinchero

Mark P. Trinchero djr

MPT:djr
Enclosure
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BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Notice Of Inquiry Examining Regulation of Electric Utilities in the Face of Change in the Electric Industry	)))))	DOCKET NO. UE-940932

REPLY COMMENTS OF THE WASHINGTON INDUSTRIAL COMMITTEE FOR FAIR UTILITY RATES

Grant E. Tanner
Mark P. Trinchero
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Portland, Oregon 97201

April 28, 1995

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Notice Of Inquiry Examining Regulation of Electric Utilities in the Face of Change in the Electric Industry	)))))	DOCKET NO. UE-940932

REPLY COMMENTS OF
THE WASHINGTON INDUSTRIAL COMMITTEE
FOR FAIR UTILITY RATES

I. INTRODUCTION

Pursuant to the Commission's invitation for reply comments, the Washington Industrial Committee for Fair Utility Rates (WICFUR) takes this opportunity to briefly address several issues raised by a number of parties in the opening comments filed in response to the Commission's Notice Of Inquiry (NOI). These reply comments are not intended as a compendium of every instance in which WICFUR agrees or disagrees with positions taken or recommendations made by the other parties that have filed comments in this proceeding. Instead, these reply comments: (1) focus generally upon a number of basic principles and goals that WICFUR shares with various other commenting parties, and (2) challenge certain positions taken and proposals made by other parties.

Many of the opening comments support the axioms to which WICFUR adheres and which WICFUR enunciated in its opening comments. Indeed, following a review of the opening comments, WICFUR remains

convinced that the following general principles must form the parameters of the Commission's inquiry.

First, competition in retail and wholesale level electricity markets is desirable and will occur. Whenever possible, the Commission should rely upon emerging market forces to develop innovative solutions to competitive pressures, rather than the centralized control and planning of traditional regulation.

Second, with the rapid increase in large commercial and industrial customers' rates over the last five years, Washington's investor-owned utilities (IOUs) will lose their larger customers to self-generation, to utilities located elsewhere that can provide lower cost service, to "municipalization," or to retail wheeling, unless they are permitted to pursue flexible market-based responses to these pressures.

Third, the IOUs' "partial requirements" customers should be able to choose from a variety of electric services and service providers, including unbundled services provided by utilities and rebundled services provided by utility, or non-utility aggregators. The IOUs should be economically indifferent to the origin or ownership of electricity that is delivered to such consumers.

Fourth, competitive IOU services should be unbundled, including generation and transmission, in order to allow partial requirements customers to access competitive markets. Rates for unbundled services should reflect the actual cost of providing service.

Fifth, the IOUs should focus on reducing rates to partial requirements customers, enhancing and unbundling non-monopoly services and retaining load in the face of increasing competition. This focus will ultimately prove the best possible means of ensuring IOU profitability as markets become increasingly competitive.

These goals can be achieved in a number of ways. WICFUR continues to recommend a regulatory construct that recognizes the distinction between "partial requirements" customers and "monopoly" customers. The opening comments of the Washington Water Power Company (WWP) reflect similar recommendations. In addition, IOUs should be granted the flexibility to respond to industrial customers' needs through: (1) interruptible or dispatchable service options; (2) affiliate wheeling; (3) special contracts; (4) wholesale pooling (e.g. aggregation of competitive supply and related delivery); and (5) retail wheeling. This list is merely representative of the type of innovative responses that IOUs and their partial requirements customers must have the ability to pursue. WICFUR urges the Commission to take an approach to regulation that will facilitate such responses to the evolving industry structure.

With these precepts and recommendations firmly in mind, WICFUR takes this opportunity to respond to various issues raised in the opening comments of other parties.

II. Market Forces Versus Command and Control Regulation

At the heart of this proceeding one question remains paramount: in the context of an evolving electric industry, should the Commission rely upon market forces to shape the manner in which electric services are provided, or should it instead manage the industry directly through command and control regulation? As expressed in WICFUR's opening comments, market forces should be used to the greatest extent possible to shape creative solutions to market challenges, not centralized control and planning of traditional regulation.

The vast majority of the other parties filing opening comments have, either implicitly or expressly, voiced the same belief. Accordingly, many have called upon the Commission to regulate the IOUs in a manner that allows maximum flexibility to fashion meaningful and innovative responses to competitive pressures, both at the wholesale and retail level. Indeed, both the IOUs and many of their customers have requested this flexibility.[1]

As discussed in WICFUR's opening comments, the competitive pressures being felt in the Northwest's retail electric markets did not appear without cause. In large part, existing command and control regulation has led to market distortions that are not sustainable. Therefore, WICFUR urges the Commission to

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[1]PacifiCorp (Pacific) and Washington Water Power (WWP) are the most strident in this respect.

reject any recommendations that call for an expansion of existing command and control regulation.

WICFUR is encouraged by the general tenor of the comments filed by Pacificorp and Washington Water Power. These IOUs appear to recognize both the benefits and the inevitability of competitive power markets. Electric markets will evolve -- rapidly -- along the competitive models already established in the natural gas and telecommunications industries. Traditional suppliers who anticipate these market changes stand every chance of prospering in a competitive environment. Those who do not will experience the fate of noncompetitive suppliers in any industry: economic obsolescence.

Puget's comments in contrast suggests the opposite, imploring the Commission to stand in opposition to this trend, continue and increase the protections of traditional regulation. At bottom, Puget is still laboring under the false assumption that regulation grants utilities an entitlement to collect monopoly rents.

Puget makes the extreme recommendation that "[ũ]tilities and other suppliers not currently under the Commission's jurisdiction would need to be moved under that jurisdiction in the advent of open retail markets." Response of Puget Power to Notice of Inquiry, pp. 9-10. While the quoted passage makes reference to competitive markets, competition seems to be the farthest thing from Puget's mind. If regulators, instead of markets, set prices for all suppliers, Puget stands the best chance of benefiting from

a system of "shared monopolies" and monopoly rents. Competitive markets are far less forgiving of imprudent resource expenditures and other costs than traditional regulation.

Puget's hypothesis of expanded statutory authority for this Commission is far fetched. Any legislative proposal to turn back the clock on competition would be contrary to the clearly established pro-competitive policy of Washington energy law. Legislative or administrative restrictions on competition would face vigorous opposition from every sector of the Washington State economy. If Puget seeks a level regulatory playing field among all suppliers, the best answer lies in open competition, not expanded regulation.

In addition, the Commission should reject the recommendations of those who advocate an even greater degree of micro-management than that currently embodied in the Commission's least-cost planning, and competitive bidding rules.[2] The provision of electricity by the IOUs cannot withstand further manipulation that unduly raises the prices for services delivered to end users. Those customers with ever increasing options (e.g., partial requirements customers) will simply not bear such inflated prices in the long run. Instead, the Commission should focus on providing general guidelines within which the IOUs can operate in a manner that will allow them to compete to retain these customers.

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[2] See generally opening comments filed by the Northwest Conservation Act Coalition, the Natural Resources Defense Council and Northwest Environmental Advocates.

III. Penalties Associated With Customer Choice

Competition in retail electric markets will, over the long-run, work to reduce rates for all customers. Competition is receiving its initial impetus among bulk customers with the greatest costs and greatest potential gain. Once the competitive template is developed by bulk customers (often at significant transactional cost), other customers with smaller loads will follow suit. Ultimately, all consumers can realize the benefits of competition as suppliers feel the continuous pressure of market discipline. Residential customers can be among those reaping competitive benefits through vehicles such as pooled purchases, better demand management -- even municipalization as an ultimate tool against the most resistent monopoly suppliers.

However, several parties, having chosen to focus on the near-term, recommend penalties be imposed on customers that choose to obtain generation services from a different supplier than the IOU from whom they have in the past received service. These proposed punitive measures take various forms, including an "exit fee," a "volumetric distribution charge," a "non-bypassable, volume-based system benefits charge," or a "non-return"[3] policy. The calls for such measures are based in large part upon the blanket assumption that vast amounts of stranded investment will exist when retail competition is introduced.

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[3]This refers to the notion that customers that have left an IOU's system are not permitted to return, regardless of reasonable notice provisions.

WICFUR is not convinced that significant stranded investment will exist in the Northwest.[4] Furthermore, as noted in WICFUR's opening comments, the Commission does not have regulatory authority to impose any further charges on customers that cease to take service from an IOU. A customer that chooses to take service from an alternative vendor in an open retail electric market is no different than, and should be treated the same as, a customer that leaves an IOU to become part of a "municipal" or "public" power entity. Under Washington law, neither would be charged for leaving the system of the IOU that formerly provided service. Indeed, imposing a charge on the former could result in uneconomic bypass in favor of the latter.

Nor can a charge be imposed on IOU customers that leave the IOU's service territory or choose to close their facilities. The Commission's jurisdiction extends to the rates, terms and conditions that an IOU can impose upon a customer that requests service. The Commission has no jurisdiction to require actions on the part of customers. Accordingly, the Commission should dismiss all proposals for penalizing customer choice in electric service providers.

IV. CONCLUSION

WICFUR looks forward to the Commission's initial response to the comments filed in this proceeding to date. WICFUR

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[4]In this regard, WICFUR concurs in the discussion set forth in the opening comments of the Northwest Independent Power Coalition.

encourages the Commission to establish a set of governing principles consistent with those contained in WICFUR's opening and reply comments that can then be used by the Commission and the parties as a template for developing the mechanisms and environment needed to permit utility customers to obtain the benefits of competitive markets.

DATED this 28th day of April, 1995.

Respectfully submitted,

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Grant E. Tanner
Mark P. Trinchero

By: _____
Mark P. Trinchero
Attorneys for WICFUR

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WA Public Utility Districts Assn.

The Public Interest and the Future of the Electric Utility Industry in Washington

Submitted by the Washington Public Utility Districts Association
to the Washington Utilities and Transportation Commission

April 28, 1995

The Public Interest and the Future of the Electric Utility Industry in Washington

The Washington Utilities and Transportation Commission recently initiated an inquiry into the structural changes taking place in the electric industry. The WUTC is interested in the implications of these changes for utility regulations, and its regulatory role.

Because Public Utility Districts are regulated directly by their elected boards they normally do not respond to WUTC Notices of Inquiry (NOI). However, this particular NOI is an exception. The WUTC is interested in broad questions having to do with the structure of the electric utility industry in Washington state and its future development and regulation. Public power serves 62 percent of the state's electric needs (IOUs serve 38 percent), and most of the new developments in the electricity industry, such as the increased activity of Independent Power Producers (IPPs) and the debate over retail wheeling, are issues that affect public and private power. Recently private utilities have revived their historic rhetoric that the "playing field" with public utilities is "uneven." We are taking advantage of this NOI to: 1) state the principles under which we operate; 2) comment on trends in the electric utility industry; and 3) address the "level playing field" issues raised in the NOI and by some respondents.

I. Operating Principles of the PUDs

Local public power systems are deeply rooted in the history of our country. They were created on the premise that electric power is an essential public service, and should be either owned and operated by the public, or regulated by the public when service is provided by private utilities. The authority to create Washington PUDs was established by an initiative of the people in 1931. The purpose of the initiative was to extend the benefits of public power to unincorporated and IOU served areas, provide local control over utility service, and to provide service area competition to existing utilities in a monopoly industry. We believe our unique law is a well tested expression of the will of the people in a democracy. Its principles include:

- The right of people to create a consumer owned public utility district.
- The right of eminent domain, which is necessary for the will of the majority to be exercised and to maintain a viable alternative to private power.
- Governance by a commission elected by the customers.
- The payment of state and local taxes at rates similar to those of other utilities.
- The right to finance by revenue bonds.

The PUDs brought real competition to electric utility service in giving a choice to the people in Washington. When a Washington community has chosen public power, it has almost never returned to private utility service--but it could. The PUD law provides for dissolution and the possibility of return to private utility service. The pressure of service area competition, giving citizens a choice of utility service provider, is a great benefit to the state of Washington and its citizens. This system provides a "yardstick" of service cost and quality among utilities. Many factors contribute to Washington state having some of the lowest electric rates in the nation, but competition between public and private power is one of the most important.

II. Industry Trends Impacting Electric Utilities and Regulation

There are many factors driving the current changes in the electric utility industry. One of the most important factors is that it is a declining cost industry. For years, new generation cost more than old generation. That has been turned around with important consequences. New non-utility providers of generation, the IPPs. have appeared on the scene. The appearance of IPPs in large numbers is attributable to increased efficiency of combustion turbines, low natural gas prices and regulatory changes at the national level. The 1992 Energy Policy Act (EPAct) promoted the upsurge in wholesale competition because it gave utilities access to transmission, and thus access to wholesale suppliers including IPPs, that they could not formerly reach.

So far the increased competition has been primarily for wholesale customers. Industrial customers are very interested in extending this competition to the retail level, and they are seeking, regulatory changes which will allow them to be served directly. There are thus two levels of increased competition that are being discussed in Washington state and elsewhere as part of the utility industry restructuring: wholesale and retail market competition.

Wholesale competition is here today and driving much of the utility restructuring. For example, Clark Public Utilities, a BPA customer, has new short-term power purchase agreements with two Washington IOUs Washington Water Power and Pacific Power and Light will provide about one-half of Clark's power supply while it builds its own combustion turbine generating plant. Other PUDs that have been full requirements customers of BPA are close to contracting with IPPs or other utilities for power supply. There is, in fact, very vigorous competition to provide wholesale power among IPPs, utilities and utility affiliates. Retail wheeling, on the other hand, while widely discussed, is in its infancy. Because EPAct didn't change or restrict state and local authority to control retail wheeling, it encouraged a trend toward debate, promotion of, and agonizing over retail "wheeling," but so far little real action in the states.

On March 29, 1995 the Federal Energy Regulatory Commission (FERC) offered a proposal to restructure the wholesale utility industry. This is a major development with implications that we will need additional time to analyze. FERC did indicate it intended to leave to the states decisions with respect to retail wheeling.

The WUTC has so far been moving slowly toward implementing a right of retail wheeling. It seems a prudent strategy to watch what happens in California and other states where high rates are driving regulators to implement a retail wheeling, free market regulatory structure.

Before regulatory bodies, the WUTC, or city councils and PUD boards turn to the market to regulate retail energy sales, they need to know competitive markets will really work. Monopoly abuse has been controlled in the past by improving national and state regulation, and by service area competition from public power. These protections for the

consumer won't be readily replaced by a complex but likely imperfect free market at the retail level in which some industries do well, while other businesses and residential customers are disadvantaged. The "theory" that the competitive market can operate in retail energy sales is so far just that, a theory. In our view, retail competition will not presently meet the common purpose that the WUTC and PUDs share of protecting the consumer.

III. Other questions raised in the NOI

A. *Restructuring or privatization of BPA (p.10).* The PUDs oppose the privatization of BPA. BPA is currently under pressure from competitive markets and, as a result, is undergoing major reforms labeled "reinvention." BPA is no longer necessarily the lowest cost provider, as evidenced by the public power utilities that have contracted with other power suppliers, including IOUs. Many public systems currently are soliciting power supply proposals from non-BPA sources. BPA will continue to be a wholesale supplier and as such will not compete for the retail customers of utilities. BPA should be allowed the flexibility to market its "unbundled" services in as free a manner as possible for the benefit of all Northwest utilities, consistent with current law. As the supplier of 80 percent of the region's transmission services, the open access provisions of the 1992 EPAct are important to the current vigor of this wholesale power market. We oppose any transfer of costs from generation to the transmission system, that would restrict open access and conflict with the public power principle of cost-based rates.

B. *"Will utilities in a competitive market invest (in conservation) for resource acquisition?" (p.10).* Public Utility Districts are committed to engage in integrated resource planning processes and acquisition of conservation. As BPA customers, PUDs are in the process of negotiating new contracts that transfer much of the responsibility for conservation to themselves. PUDs are convinced that they can develop the conservation resource more effectively if they do so directly than through BPA. The PUDs have established mechanisms such as the Conservation and Renewable Energy System (CARES) to facilitate development of these resources.

The measure of success in this process should not be the number of dollars spent, but the actual achievement of conservation goals and commitments.

C. *The "decentralized electricity system" (p. 10).* New site specific fuel cells, solar, and small scale gas-fired generation may lead to a more decentralized electricity system. From our perspective, these developments if (or as) they occur, will be welcome. Because these decentralized generation systems are likely to develop gradually, we are confident that our utilities and boards can adapt to and effectively use these new technologies.

IV. The "Level Playing Field"

In addition to the above, the NOI in Attachment A asks: "Consumer-owned utilities service over one-half the electricity market. What actions and policies would you recommend to the Commission to ensure that the companies it regulates can compete fairly in Washington's electricity market place?"

Recently Washington's private utilities in response to the NOI and in other forums, have been increasing their calls for a "level playing field." They have been focusing their rhetoric on three historical targets: public power's access to municipal bond financing, preference in access to federal hydropower and the authority of public power systems as municipal corporations to use eminent domain (condemnation) powers. These are possibly the areas which the commission is referring to in its reference to "competing fairly." Our view with respect to these "historical targets" is:

1. Municipal Bond Financing. Provision of public power is a recognized legitimate function of local government as much as water, sewer, schools, libraries and other traditional services. Attacks on public power municipal bonds are also attacks on local government's use of tax-exempt financing. PUDs and municipalities do not have access to capital markets, issue stock or have holding companies. Municipal bonds are currently highly restricted in their use. They cannot for example be used to buy out private power facilities. Local governments use of municipal bonds is a broad issue of federal law and tax policy, and the IOUs' narrow efforts to

target one municipal use should be resisted. Taxes on municipal corporations like PUDs are taxes passed through to the general public. Taxes on IOU owners, on the other hand, are taxes on private investors who are a small segment of the public and whose purpose is profit. Nationally less than 1/4 of the rate differential between public and private power is due to tax-exempt financing. Most of the rate differential between public and private power is due to public power not paying a profit to stockholders (this money remains with consumer owners) and to efficiency and low operating costs in management salaries and other areas. [see Kwoka]

2. Preference. The report cites preferential access to federal hydropower as a subsidy to public power. The increasing costs of BPA-marketed federal power no longer confer a significant advantage to public power. So far, actual operation of the increasingly competitive wholesale market indicates that IOUs have the advantage. PUDs are negotiating with and purchasing far more new power supply from IOU's than the other way around. BPA has been losing, not gaining, customers in the real wholesale power market. Preference has a historical justification in that it delivers directly to the public the benefit of public resources (the rivers). This power is available to consumers served by IOUs as well as public utilities through the exchange provisions of the 1980 Northwest Power Planning and Conservation Act. In our view, the federal dams produce power that ought to benefit consumers directly, and not be a source of profit.

3. Condemnation Authority. Like other municipal governments in Washington, PUDs have condemnation authority. Private utilities also have condemnation authority which they use extensively to procure rights of way and site power facilities. The right of "eminent domain" of local governments is a fundamental power necessary to their ability to function. This authority has not been used to acquire private utility facilities in over 40 years. Though historically most sales of private utility systems have been negotiated, there would be few or no public power systems in Washington if municipalities and PUDs had not possessed his authority. Where IOUs have provided good service and reasonable rates they have had little to fear from public power. Where they have been unable or unwilling to provide this

service, they have often attempted to restrict the public's ability to provide an alternative through its power of eminent domain. The power of eminent domain is absolutely essential to making public power a credible alternative to private power.

The WUTC should be wary of calls for it to ensure that the companies it regulates can "compete fairly." Before focusing on the supposed "unfair" advantages of public power, the WUTC ought to reflect on the advantages enjoyed by IOUs. Such special privileges as billions of dollars in "accumulated deferred taxes" under the 1986 Tax Act; ability to conduct business behind closed doors (the PUDs conduct their business under the open meetings law and similar freedom of information requirements); and the IOUs are also able to engage in profitable subsidiary, affiliate and holding company deals that PUDs and other publics do not engage in. The IOUs have the ability to compete without seeking restrictions on public power that would increase our costs and hamper our ability to operate.

As the discussion of retail competition has developed, some concerns have been expressed that PUDs might engage in retail competition outside their service areas. PUDs have not engaged in retail wheeling in the past nor do we foresee the implementation of retail wheeling and retail competition soon. Several PUDs engage in direct competition with local IOUs where the PUD does not serve throughout its established service areas (Asotin, Kittitas, and Whatcom PUDs have been established by citizens in these counties, but do not yet serve their entire authorized service areas.) These instances of direct competition for customers are not retail wheeling because these utilities are serving inside PUD service areas established by the electorate.

In looking at regulatory reform to increase competitiveness and enhance the ability of the market to protect consumers, we recommend the WUTC work toward enhancing the flexibility and competitiveness of those it regulates. It has done this, for example, in its rate "de-coupling" experiment with Puget Power. In short, the WUTC should focus on making those it regulates more effective rather than increasing the costs or restricting the authority of public power systems.

V. Conclusion

We have attempted to address the range of issues related to PUDs that the WUTC raises in its NOI, including our position on the long-term competitive relationship between public and private power. Our main points are:

1. Public-private power competition has been good for the state of Washington, and will continue to benefit its citizens. While this competition may make some utilities unhappy, citizens benefit.

2. The WUTC and policy makers should be wary of private utilities' allegations of uneven playing fields and unfair competition. Washington citizens have heavily opted for public power over private power because they want local control and the "profit" from electric utilities to stay with their citizen owners and communities.

3. The WUTC should focus on reforms that make private utilities more efficient, rather than on ways to restrict or regulate public power. The WUTC and policy makers should not attempt to extend a duplicate regulatory system over PUDs and other public power utilities.

SOURCES

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Kwoka, John E., "Public Versus Private Ownership of Electric Utilities: A Comparison of Price Performance," George Washington University, 1995.

U.S. Department of Energy, "Financial Statistics of Investor-Owned Utilities," 1993.

Washington State Energy Office

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May 3, 1995

Steve McLellan
Commission Secretary
Washington Utilities and Transportation Commission
1300 S. Evergreen Park Drive SW
P.O. Box 47250
Olympia WA 98504-7250

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Subject: Notice of Inquiry Regarding Electric Industry Restructuring,
Docket No. UE-940932

Dear Mr. McLellan:

Enclosed, are ten copies and a 3 1/2" diskette containing the Washington State Energy Office's (WSEO) reply comments in the above proceeding.

We look forward to reading other parties' reply comments and participating in the next phase of this proceeding. As with the first phase, communications regarding these comments or WSEO's participation in this proceeding should be directed to Deborah Ross at (360) 956-2124 or Mark Anderson (360) 956-2012 of our Policy Section.

Sincerely,

Judith Merchant
Director

JM/ked
D-M3-77W6

Enclosures

State of Washington Utilities and Transportation Commission

Inquiry Regarding Electric Industry Restructuring	)))	Docket No. UE-940932

Reply Comments of Washington State Energy Office

Overview

The Washington State Energy Office (WSEO) has reviewed all thirty-seven comments submitted in response to the Washington Utilities and Transportation Commission's (Commission) Notice of Inquiry. Both the scope and the quality of the comments you received were impressive. We identified about seventeen issues that were each discussed by at least two commenters (see Attachment 1). Of these seventeen, we found eight that seem to be key themes for this proceeding. Of these, five evinced a strong majority position; with three others, the opinion was much more split.

Five issues upon which there is a clear majority of opinion are as follows:

- Competition and other regulatory mechanisms are means, not ends in themselves. The Commission must clearly articulate its goals before determining whether remedies are needed to meet those goals.
- Nearly all commenters believe that changes are needed to the way the Commission determines the reasonableness of utilities' resource acquisition decisions. Suggestions for change range from a minimum of asking the Commission to establish clear policies that will create more certainty about recovery of costs, to pre-approval of specific resources.
- Wholesale competition is beneficial to society; although a competitive market is not yet perfect, little additional state regulatory action is currently needed to foster this competition.
- Stranded cost/stranded benefit recovery mechanisms should be considered as part of any regulatory restructuring process.
- Utilities should consider environmental impacts in their resource acquisition decisions.

Three issues evincing lively discussion, but with significant ranges of opinion are:

- The need for and nature of integrated resource planning;
- The desirability of retail competition or retail wheeling;
- The need for amendments to the bidding rule.

For the most part, WSEO sees little need to respond to others' comments on these issues; or to supplement our own. WSEO believes it serves no purpose to repeat what we or others have already said. We anticipate that the workshop phase will include an opportunity to flesh out all parties' positions in more detail, and will allow for more immediate give and take. We do want to take the opportunity to provide supplemental comments on a limited number of issues. Our comments are in two parts. The first part responds to others' comments on issues we raised in Phase 1. The second part responds to comments that addressed issues we did not raise in the first phase.

Part 1: Response to Select Issues Addressed by WSEO in Phase 1

Integrated Resource Planning (IRP)

WSEO was among the majority of commenters who believe that IRP should not be abolished, in fact, it should be enhanced. However, IRP is also consistent with, in fact, is a crucial element of, the need for a utility to be flexible enough to respond to changing opportunities. As more opportunities become available, it becomes even more important to develop a strong decision making framework. This is especially true if it is not easy to compare resources (long-term versus short-term, dispatchable versus non-dispatchable, peaking versus baseload, contracts versus utility-built, etc.). Only by developing and maintaining reliable, flexible and robust tools to evaluate these resources can utilities take full advantage of the plethora of available opportunities.

The importance of the public nature of IRP should not be understated. If the industry is moving toward greater retail competition, customers need to know a number of things in order to make informed decisions. For example, 1) how reliable is the utility's source of supply versus the competition's; 2) what are likely ranges of cost among utilities and other suppliers; 3) what other unbundled services can the customer expect from its native utility?

The natural gas industry can provide a useful lesson to the electric industry concerning the value of integrated resource planning.[1] Until quite recently, the natural gas distribution companies had only one source of resources, the pipelines, and retail customers had only one source of supply, the distribution company. All this changed with the series of FERC orders that deregulated supply, turned pipelines into common carriers, and facilitated retail bypass. In this atmosphere, the advent of utility IRP was beneficial both to gas utilities and to customers. For gas utilities, IRP allowed a structured way of comparing the newly available resources on a consistent basis. For the first time, for example, gas distribution companies had to compare storage, liquefied natural gas, firm pipeline capacity and demand side measures, and determine which met their needs the best and most cost effectively. For retail customers, IRP provided a forecast of the level of reliability they could expect as firm customers, interruptible customers, or transportation customers. This allowed the customers to make service level decisions based on anticipated cost and reliability factors.[2]

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[1] We appreciate the irony of this observation. The natural gas industry has been advised to look to the electric industry for guidance on how to perform integrated resource planning. However, when it comes to competitive retail challenges, regulatory restructuring, and uncertainty of supply and demand, the electric industry is starting to emulate the natural gas industry more than vice versa.

[2] At a recent workshop on gas integrated resource planning sponsored by the U.S. Department of Energy and National Association of Regulatory Utility Commissioners, there was unanimity that gas utilities need to undertake long range resource planning. However, there was a lack of consensus whether the process should be public or mandated by a regulatory body. There was significant agreement that a simple rule such as WAC 480-90-191 better allows for sufficient flexibility to respond to changing market conditions than a rule that spells out in detail how a utility is to respond and approves specific resources based on the filed plan.

Need for Secrecy Regarding Competitive Opportunities

There was an even split among commenters about the need to keep the utilities' competitive opportunities secret. WSEO continues to believe that secrecy harms competition rather than fostering it. Since we filed our initial comments, we became aware of a new study published by the Lawrence Berkeley Laboratories that analyzed the results of several competitive bid processes. In the report, the authors take a strong position against secrecy of the bid process. The Report states:

> We believe policies that implicitly or explicitly preserve contract confidentiality impede the creation of a competitive bulk power market. Public prices improve both the value of bids made by developers and the decisions made by utility buyers and regulatory commissions.

Comnes, et al., "The Price of Electricity from Private Power Producers, Stage II: Expansion of Sample and Preliminary Statistical Analysis," February 1995, at 39 (excerpts in Attachment 2). The Report points out that it is to the benefit of current participants in the energy resource industry to support confidentiality, at least in the short term, for a variety of reasons. Most of these reasons have to do with keeping the price up and regulation down. Significantly, the Report also found that utilities' location and the forecast price of *coal* were highly correlated to the bid price of power. Both of these factors are key components of many utilities' avoided costs, but not necessarily bidders' production cost (at least, for a gas-fired plant). This suggests that the purchaser's value, not the producer's cost, are key factors influencing the price of bid power. In a competitive market one would expect to see price more closely aligned with the seller's marginal cost of production. However, when bid prices are secret, bidders may be more likely to base their bid on the only competitive information available to them: the purchasing utility's avoided cost.[3]

We recommend that the pros and cons of secrecy be further explored during the workshop phase. It would be particularly useful for those favoring secrecy to provide evidence that secrecy fosters, rather than hinders, competition and efficiency.

Need for Public Participation

Several commenters, including WSEO, remarked that a key feature of regulatory reform at the Commission would be to have more public access to information and better opportunities for public input. WSEO focused its remarks on a concern that major policy directives not be issued at the Commission's Wednesday agenda sessions. Other commenters complained about their perceptions that public witness hearings are window dressing, or on their frustration with the complexity and opacity of the regulatory process. These comments lead to the conclusion that examination of the Commission's ability to accommodate "nontraditional" stakeholders' interests is in order. We leave it to the Commission to decide whether to make this examination part of this inquiry, or to pursue it in the context of a broader inquiry into its regulatory and public processes.

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[3] Another approach would be to abolish the requirement that utilities develop and publish avoided cost. This would likely require federal legislation to modify Public Utilities Regulatory Policies Act (PURPA). However, even if avoided cost is not published, the public interest in knowing what utilities' resource options are will tend to make the utilities' costs more public than independent power producers'. Two utility representatives, reviewing a draft of these Reply Comments, suggested to WSEO that a compromise resolution of this issue might be to disclose the results of only successful bids.

The ability of all stakeholders to have access to, and participate in, resource decisions, is clearly an issue for this proceeding. Part of the concern over secrecy of bid documents is our belief that, as industry becomes more competitive, there will be more and more resources acquired competitively. Until recently, regulators examined the prudence of a utility's resource acquisitions in an open proceeding, with procedural opportunities for input from all stakeholders. If competitively acquired resources are kept confidential, with access to terms and conditions only by commission staff and public counsel, the state will lose a key opportunity for members of the public, other agencies, and interest groups to participate.

One of the key elements of integrated resource planning is that it brings utility resource planning out in the open. This is important for two reasons: first, the public entrusts the utility to act in its best interest, and to minimize costs to the public in the broadest sense of the term. Second, the more a utility's decisions are subject to the light of day, the better we believe the decision making process will become.

Utilities and others may claim that a more public process will raise costs. Some cite concerns over competitive advantage, regulatory burden, and the lack of flexibility that ensues from rigid adherence to publicly mandated standards. WSEO shares some of these concerns, but believes that a public process can accommodate them. There are many models available throughout the country for highly competitive utilities who have chosen, or been forced, to be open about their decision making process. The next phase of this proceeding should examine some of these models.

Retail Competition

Opinions were about evenly split about whether or not to support retail competition. WSEO's first phase of comments supported retail competition if certain conditions are met: to wit, that it is structured in a way that promotes our vision of equity, cost reduction, and reliability. We will comment below on one element of equity, the stranded cost/benefit issue, in Part 2. Here, however, we would draw the Commission's attention to two unrelated newspaper articles that appeared in recent weeks that point out some of the potential dangers to retail competition. The first article in the *Wall Street Journal* was captioned "Utility Privatizations Backfire in the U.K.," WSJ 3/30/95 (Attachment 3). The article noted that deregulation of the industry has led to enormous profits for the industry, ranging from 84 to 240 percent. On the one hand, the article supports utilities' claim that loosening regulation will allow utilities to find cost savings and profit making opportunities that they had not found while regulated. On the other hand, it appears that these cost savings are not being passed on to customers at a publicly acceptable level. The article notes, "Consumer groups question why household bills are rising even as company profits go through the roof ... The British public may not stomach big utility profits, no matter how well the industry is regulated."

The second article is in the *Olympian* of April 5, 1995 (Attachment 4). The article, captioned "House Endorses US West Protection," is an interesting follow-on to another *Olympian* article that we cited in our original Notice of Inquiry (NOI) comments (see footnote 22, page 21). In that footnote we remarked that US West was seeking to double its residential rates in response to retail competition threats. This, we suggested, was evidence that claims of retail competition's *universal* benefits might be exaggerated. More recent news suggests that regulatory efforts to implement retail competition may be subject to political backlash. The April 5 article notes that the House and Senate have sent a bill to the Governor for signature that preserves US West's monopoly on 1-plus local calling. It states that "backers of the measure cited US West's inability to compete as reason enough to vote for it." The Governor vetoed the legislation on April 18, 1995.

The lesson to be learned from these events (as we understand them solely from newspaper accounts) is that political events can overtake regulatory solutions. Laying the foundation for introduction of competition and taking care of stranded cost, cost allocation, shareholder concerns, and other equity issues can help to ease the transition to competitiveness. The Commission has the opportunity to learn from others' experience and should undertake or review studies of others' success and failure before implementing any new regulatory mechanics.

Part 2: Additional Issues Not Discussed in Depth by WSEO in Phase 1 Comments

We now turn to topics that we did not address at length in our original comments, but that other commenters highlighted.

Stranded Investment, Stranded Benefits

The terms stranded investment and stranded benefits refer to a grab bag of concerns that may or may not fall into the economist's classic definition of stranded investment. These terms have been used to refer to situations where, under traditional embedded cost pricing, the purchaser's cost of electricity is higher than the cost of its potential alternative sources of power. This could be the case for several reasons, all of which exist today to some extent:

1. the utility made resource decisions that, on a life cycle basis, are higher than today's cost of resources (e.g., dead nukes, some qualifying facility contracts);
2. the utility is making resource decisions that are cost effective in the long run but whose first cost is higher than the first cost of alternative resources (e.g., cost effective demand side measures, renewables compared to cost of gas-fired generation);
3. the utility is making "social" investments that are cost effective from society's perspective but not from a direct energy cost perspective (e.g., environmental adders, low income subsidies, research and development).

Except for the last category of costs, the relationship between marginal and embedded costs changes periodically over the years. While embedded costs are higher than marginal costs now, the relationship may reverse in the future (see graphs in Attachment 5). It is hoped that the magnitude of the difference between embedded and marginal cost will become progressively smaller over the years as we learn from past mistakes and miscalculations. However, there will always be breakthroughs in technology that will lower current costs at the same time costs of older resources are still being paid for. The current low cost of new resources is the result of technological breakthroughs in drilling, exploration, and generation technology; regulatory changes; and increased coordination. Changes leading to lower costs in the future could include dramatic breakthroughs in transmission technology, fuel cells, fuel extraction, and as yet unforeseen changes. Likewise, there will be situations in the future where new resources will be more costly than older, depreciated ones.

A large number of commenters to the NOI, representing a wide spectrum of interests, supported some sort of cost recovery of stranded investments/stranded benefits. Reasons given were primarily equity concerns and fears that, without recovery, utilities would not invest in priority resources such as demand side measures and renewables.

WSEO has reviewed proposals made by a number of commenters here and in other proceedings, and has three observations, and one recommendation.

Observation 1: A fixed adder has the potential to over or underrecover stranded investment/stranded asset costs. A cost is only "stranded" if it cannot be recovered. To the extent that a utility is able to reduce its exposure to these costs, they are not stranded. A fixed adder also removes the incentive for a utility to mitigate its losses by attempting to market surplus power at wholesale, or by implementing cost cutting measures. Thus, WSEO believes that any mechanism to recover these costs should preferably recover only "net" stranded costs -- e.g., the difference between revenue requirements and avoided cost.[4] This is the approach Federal Energy Regulatory Commission (FERC) takes in its recent open access and stranded cost Notice of Proposed Rulemaking.

Observation 2: Whether the "problem" of stranded cost/stranded benefit is a transitional or a permanent phenomenon depends on the utility's obligation to serve, broadly defined. The Federal Energy Regulatory Commission's Notice of Proposed Rulemaking defines stranded investment as a temporary phenomenon. In the wholesale arena it is occasioned by the transition from an industry where utilities believed themselves to be sole providers of energy services, to a competitive regime. Thus, FERC's solution to this problem is a temporary surcharge on prices of wholesale transmission providers, via contract or as part of transmission rates.

In the retail arena, the problem is not so simple. Where a utility has either a legal or a political[5] obligation to serve, it must acquire and maintain resources to meet anticipated demand, whether or not contractually obligated to do so. Since it typically takes anywhere from several months to several years to acquire a new resource, a utility will incur a portion of its costs to meet anticipated future load. As we note above, over the years, the relationship between embedded cost and incremental cost may periodically switch. In the mid-70s and mid 80's for example, incremental cost was commonly thought to exceed embedded cost, due to high fossil fuel costs and low cost hydroelectric power. There may therefore periodically be future periods of "stranded costs/stranded benefits" as well as periods of "windfalls" where a new customer benefits from the low cost of depreciated plants. Only where a customer goes off the system and promises never to return will the cost to serve it become a temporary or transitional problem.

Observation 3: The FERC's Notice of Proposed Rulemaking on stranded cost makes it quite clear that FERC does not intend to "bail out" utilities where retail competition has created stranded cost/stranded benefits problems, except in the case of municipalization or lack of state authority. Thus, any utility seeking recovery of these costs will generally have to do so through mechanisms that are the province of the state or local regulator (e.g., the Commission or the governing body of the publicly-owned utilities).

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[4] Avoided cost must reflect opportunities for wholesale transactions, in order to ensure that it properly reflects the utility's actual incremental cost to serve retail load.

[5] We use the term "political obligation to serve" to refer to the broad principle that the electric industry has evolved into a service that is indispensable to both homeowners and businesses alike. Whether or not there is a statute that spells out the utility's obligation to meet citizens' needs for power, there will always be a political force that ensures that businesses have power to run their machinery and keep their lights on, and residents have enough power to meet basic needs.

Recommendation. Any regulatory solution to the stranded cost/stranded benefit issue needs to be the result of extensive discussion, examination, and negotiation (see the cautionary lesson regarding US West, above). However, WSEO has seen one approach that addresses some of the concerns we have over some of the alternative mechanisms that have been proposed elsewhere. This is the mechanism described by the Regulatory Assistance Project (RAP) in its March 1995, *IssueAlert* (Attachment 5). Under the RAP proposal, the retail wheeling rate (or, to avoid the appearance that it is tied to transmission, let's call it the retail competition rate, (RCR)) would be based on the difference between the utility's embedded cost and the utility's avoided cost. When the difference is positive (embedded higher than marginal), the customer would pay a positive RCR. When the difference is negative, the utility "rebates" the RCR to the customer. To the extent the customer can find power that is cheaper than the utility's avoided cost, it will still have an advantage over a customer who takes its power from the utility. However, equity concerns are met by having the customer pay for costs the utility incurred on its behalf.

This leads to a second feature of the RCR that is not mentioned in the *IssueAlert*, but is in our opinion crucial.[6] Under the proposed mechanism, the departing customer negotiates the period of time it wishes to stay away. At the end of the term, it can renegotiate for another period of time, if it desires. Thus, if the customer intends to stay away for seven years, the utility can a) make a seven-year sale of the energy and capacity freed up by the customer's departure, and b) postpone resource acquisitions that it would otherwise have made to serve that customer. On the other hand, if the customer chooses to stay away only one year, its RCR will be higher because the utility cannot mitigate its losses through long-term sales or deferments.

If the customer agrees to stay away forever, then the stranded cost/stranded benefit problem is truly transitional with respect to that customer. It would only pay a RCR until the next cross-over point, i.e., until the utility had recovered costs incurred to serve it.[7]

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[6] Telephone conversation with David Moskovitz of RAP, April 1995.

[7] The RAP mechanism is very similar to one developed by Dick Watson of the Northwest Power Planning Council to deal with the Bonneville stranded debt problem. Like RAP, the Watson mechanism proposed recovery only of "net" stranded debt with an understanding that BPA is encouraged to mitigate the loss through resale. (Although it is primarily a wholesale provider, BPA is similar to retail utilities in that it has an obligation to serve its preference customers.) BPA customers have tentatively negotiated waivers of their preference rights for seven year periods after departure, in order to facilitate long-term resale of the freed-up energy and capacity. Ralph Cavanagh also testified at a recent Senate Appropriations Committee hearing in favor of allowing BPA to make long-term sales of surplus power in order to mitigate its stranded cost exposure.

Consistency with Vision

As with the scenarios developed in our original comments, we tested the RCR mechanism for consistency with our vision.[8] Our conclusion is as follows:

Universality. As with Scenario 5 in our original comments (regulatory promotion of retail competition), universality and reliability of service become matters that are negotiated between the utility and its customers. Customers who choose to stay with their native utility continue to be protected, and customers can negotiate the amount of time they want to depart from their host utility.

Lowest costs. This option tends to lower overall costs by promoting competition. The recovery of stranded cost from departing customers might dampen the incentive for those customers to find lower cost resources; however, stranded costs must, in any case, by definition be paid by someone.

Environmental and other social cost minimization goals could be included in the RCR as an option.

Equity issues. The RCR deals with shareholder/ratepayer equity by allocating net stranded costs and benefits to departing customers. Temporal equity issues remain a concern, however, because customers negotiating short departure periods may force utilities to make short-term investments to serve them. However, the RCR mechanism greatly increases certainty concerning obligation to acquire resources for remaining customers.

Scenario RCR
Retail Competition Rate

Element of Vision	Consistency of Scenario with Vision
Universal	Consistent but modified
Safe	Consistent except for unregulated retail generation
Reliable	Negotiated
Lowest cost	
Direct	Consistent
Social	
Environmental	Consistent if included in RCR
Economic	Consistent if included in RCR
Equity	
Temporal	Largely consistent
Interclass	Consistent
Participant-nonparticipant	Consistent
Shareholders-customers	Consistent

Thus, we see that many of the concerns we have over retail wheeling are improved, if not eliminated, by implementation of a mechanism such as the RCR.

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[8] We will take the opportunity here to draw attention to an article in the March *Electricity Journal* by Barbara James of the Wisconsin Public Service Commission, which developed an approach nearly identical to ours, including a similar vision ("policy objectives") and matrices. Ms. James concludes: "setting each proposal out explicitly so that it is reviewed against all the objectives should reduce biases introduced by rhetoric and ideology and allow a more rational comparison of the choices available." B. James, "A Modest Proposal for Shaping a Reasonable New World," *Elec. J.* March 1995, at 67.

In view of the importance of this issue, and the overwhelming support for some sort of resolution of the stranded investment problem, we recommend that one entire workshop be devoted to exploring stranded investment/stranded benefit issues. The workshop should explore both the scope of the "problem" and possible solutions. While we are not recommending any particular approach, we believe the Commission should include the RCR mechanism described above in the workshop discussions as one of several possible solutions.

Affiliate Wheeling and Self-Generation

Commenters in Phase 1 mentioned two other aspects of retail competition. First, some commenters asked the Commission to exempt affiliate wheeling from the utility's effective monopoly franchise. Thus, an industry that had several locations would be able to transmit cogenerated or self-generated power to an affiliate across a utility's distribution lines. This proposal appears to have merit and could, we believe, encourage the development of cost effective resources in the state. We have also noted in our previous comments that there appears to be nothing in current *statutes* that would bar a customer from unilaterally undertaking affiliate wheeling, since there is no exclusive franchise in this state. However, no utility, to our knowledge, currently has on file a retail distribution tariff, which would be needed to facilitate this transaction. The Commission would have to approve distribution charges to ensure that the utility was compensated for the distribution cost of transmitting the power from one location to another.

Some commenters noted the "threat" of self-generation if the Commission does not take steps to promote competition and lower retail costs. WSEO does not view self-generation as a significant "threat" in Washington state. To the contrary, it is likely that self-generation offers opportunities for development of cost effective distributed resources, thereby freeing up costly transmission and distribution lines for retail and wholesale transactions.[9] The gap between embedded and incremental cost is simply not great enough in this state to promote anything other than cost effective self-generation. Furthermore, self-generation is likely to pose less of permanent stranded cost problem. A customer that invests in a costly self-generation option will be much less likely to return to its native utility in the near future. Nevertheless, we still believe that the utility's continuing obligation to serve self-generating or affiliate wheeling customer needs to be clarified in statute or through a Commission policy statement.

In both affiliate wheeling and self-generation cases, there may be problems of stranded investment/stranded benefits. These would have to be dealt with in the same way stranded costs are dealt with for other departing customers.

[9] To the extent a self-generator intends to rely on its host utility for standby or backup services, these would have to be appropriately priced to recover all costs.

Regional Consistency

A number of commenters expressed the importance of ensuring regional or statewide energy policy consistency. A particular concern is the fear that regulations place a higher burden on investor-owned utilities than is the case for publicly-owned utilities. Recent experience with BPA and publicly-owned utilities in the context of the power sales contract negotiations confirms the validity of some of these concerns. Despite months of discussion, BPA and its customers have not been able to reach agreement on how to ensure that regional priority resources continue to be acquired and maintained. Furthermore, there is increasing reason to identify the entire Western United States as a single "region," given developments in the area of west-wide coordinated transmission planning, increased numbers of north-south transactions, and the new open access Notice of Proposed Rulemaking.

Unfortunately, any solution to the problem of regional or statewide inconsistency is highly political and complex. Potential solutions that have been suggested in various forums include:

- legislation to require statewide or regional consistency;
- a state siting standard that imposes uniform resource acquisition standards on developers and utilities;
- legislated incentive mechanisms to encourage statewide and regional consistency;
- partial or full regulation of publicly-owned utilities;
- better coordination of resource planning among public utilities, private utilities, and BPA;
- dispatch of resources to reflect regional priorities; and
- transmission prices that reflect and/or recover resource costs of regional priority resources.

WSEO has no solutions to offer, but is eager to discuss these issues with the participants in this proceeding. The next phase should address this at one or more workshops.

Thank you again for the opportunity to comment on this important proceeding. We look forward to participating in the workshop phase.

Attachment 1

Tally of Major Issues Raised in Phase 1 Notice of Inquiry Comments

The following represents the Washington State Energy Office's tally of issues raised in the first round of comments in the Notice of Inquiry proceeding. Two issues are not "tallied" here because they appeared to be overriding themes in virtually all comments: 1) the benefits of wholesale competition, yet the lack of need to address with additional regulatory change; 2) the need to establish goals before undertaking regulatory changes.

Theme	Agree	Disagree	WSEO Phase 1 Position
Enhance IRP	11	8	Agree
Stranded cost recovery/wire charge	13	3	No position
Pre-approval of resources	12	2	Agree
Promote retail competition	8	7	Agree with conditions
Abolish or modify bidding	7	4	Agree with conditions
Consider environmental impacts	10	3	Agree
Protect secrecy of contracts	3	3	Disagree
De-integration	5		Consider
Protect regional goals	5		Agree
Performance-based ratemaking	3	1	Consider
Unbundling	3		No position
Better public process	4		Agree
Reduced regulation	2	2	No position
Siting issues	2		Agree
Permit affiliate wheeling	2		No position

Attachment 2

LBL-36054
UC-1320

The Price of Electricity from Private Power Producers

Stage II: Expansion of Sample and Preliminary Statistical Analysis

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February 1995

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filed for approval of its contract with Pacificorp.[23] The project is co-owned by PG&E, which owns and controls transmission facilities near the project and there are provisions in the contract which allow Pacificorp to purchase the project. Both of these reasons may explain the early filing of this project.

4.2.4 LBL Recommendations Regarding a Policy of Public Disclosure

We believe policies that implicitly or explicitly preserve contract confidentiality impede the creation of a competitive bulk power market. Public prices improve both the value of bids made by developers and improve the decisions made by utility buyers and regulatory commissions. Unfortunately, despite the social benefits of disclosure, it appears that all decision makers in the industry--developers, buying utilities, and regulators--have short-term incentives to support confidentiality. Project developers have a natural incentive to keep prices confidential. Representatives of project developers have indicated that they believe the market for bulk power is less than fully competitive (Besser 1994). Thus, they believe there is a loss of market power or competitive advantage if confidentiality is lost. For example, project developers that successfully execute a contract that is then made public can expect that the contract will, in future negotiations, represent the starting point rather than a successful ending point. The losses from making future concessions appear to outweigh the possible gain in market share that a developer would experience.

Similarly, utility buyers do not have strong incentives to disclose contracts; they receive full price information from bidders and releasing contract prices only dilutes any market power they hold and opens themselves to second-guessing by regulators. Further, with the possibility of "direct access" (retail wheeling) increasing, disclosure of generation capacity and energy prices can increase large customers' interest in bypassing the utility.

While the expectation of losses can explain the positions of developers and buyers, it is harder to justify the explicit or de facto policy of many state PUCs to allow for contract confidentiality. PUCs presumably serve the public interest but several commissions appear sympathetic to confidentiality requests because (1) the commission or its staff can get the information it needs to conduct an analysis of contract net benefits and (2) they appear to believe that disclosure will reduce the effectiveness of the bidding process. Individual participants in the bid process may complain of economic losses as a result of disclosure and sometimes argue that they will not participate in an open auction. From a societal perspective, however, these losses to individual participants should be outweighed by the gains low-cost bidders make in market share and an increase in welfare to consumers that benefit from lower cost power. Certainly, the benefits of contract confidentiality, if any, would only accrue up to the point in time when parallel RFPs by the same or similarly-situated utilities come to a close. At that point, there should be no reason not to make contracts public. For state

[23] FERC has ruled on the Hermiston application and denied the applicant's request for market-based rates.

regulators that do not wish to make bid prices or contracts public, we suggest a balance between the possible private costs and the societal benefits of disclosure by advocating that contracts be released after a certain amount of time has passed.

Another way to improve disclosure policy is to improve the reporting of project prices once they become operational. FERC, for example, could make private power producers subject to the same statistical reporting obligations as public utilities. Currently, FERC-regulated utilities above a certain size are required to file Form 1s with a breakdown of purchased power costs by seller.[24] QFs, EWGs, and smaller sellers of power have reduced reporting obligations. Current reporting requirements could result in a large number of unreported transactions in the future, especially if direct sales become more commonplace.

Other than changes in disclosure and reporting policies by state or federal regulators, the only other way that prices will become public is through the creation of publicly-traded spot and forward markets for electricity. In publicly-traded markets, price is the dominant carrier of information. Confidential negotiations to reveal pricing terms are too costly in such markets. Currently, spot and forward markets for electricity are in their most nascent stages. Further, they are not currently relied upon for long-term capacity needs. Although such markets will provide a valuable source of price revelation in the future, they will not substitute for prices as revealed in the long-term contracts market.

4.3 Summary of Major Findings and Discussion

Our levelized price calculations on our sample of contracts clearly indicate that gas technologies dominate. At an 80% capacity factor, coal projects cost an average of $0.092/kWh, which is higher than all but the most expensive of the natural gas-fired projects. The average price of gas nonpeakers is $0.069/kWh (80% capacity factor) but there is considerable variation. Two larger projects, Independence and Hermiston, have an average price of $0.050/kWh, which is 28% lower than the sample's average price. Further, the general dominance of gas-fired technologies is robust over a wide range of gas price escalation rates. Even if natural gas prices are assumed to escalate at 4%/year real, natural gas projects are generally cheaper than the coal projects.

The most surprising and perhaps anomalous result of our levelized price analysis is the apparent dominance of the gas combustion turbine projects (gas peakers). Gas peakers, with their low capacity costs but relatively higher heat rates, are intended to fill a niche at low annual capacity factors. Although the peakers are the cheapest gas-fired resources at a low capacity factor (40%), they are also competitive with gas nonpeaker projects at an 80% capacity factor. As we discussed in Chapter 3, there are reasons that make us believe the

[24] Some utilities in the past have reported all nonutility providers on one line. FERC staff have recently worked to rectify this situation and more detailed reporting should now be the norm.

Attachment 3

Wall Street Journal 3/30/95

Utility Privatizations Backfire in the U.K.

High Profits, Salaries May Bring Regulatory Changes

By Kyle Pope
Staff Reporter of The Wall Street Journal

LONDON—Britain's massive utilities-privatization effort, touted as a model for the world, is starting to show its flaws.

Soaring stock prices at the privatized utilities and fat paychecks for executives who run them have triggered a privatization backlash in the past month. Utility executives are being hauled before the House of Commons to answer questions on their bonuses. Consumer groups question why household bills are rising even as company profits go through the roof.

Even Stephen Littlechild, the British academic who dreamed up the industry's incentive-based rate scheme nearly a decade ago, has conceded in the past week that he misjudged how much money the privatized electric companies could make under the existing rate system.

For backers of the privatization push, the controversy has prompted a sobering realization: The British public may not stomach big utility profits, no matter how well the industry is regulated.

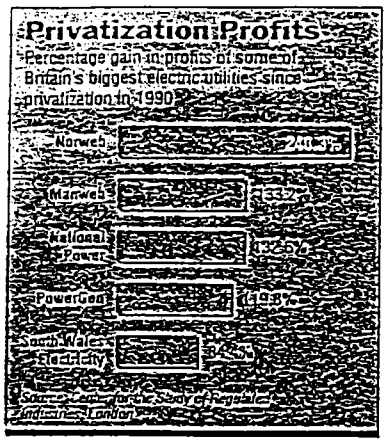
"There is something about the British psyche that is envious, even contemptuous, of people who earn large sums of money," says Henry Gibbon, editor of Privatization International, a monthly trade journal based in London. "Especially if you're a public utility."

While many other British state enterprises also were privatized in the past decade, few have come under the same scrutiny as the utilities. Indeed, most have worked well. British Airways PLC and British Steel PLC have won praise for their performance since privatization and even British Telecommunications PLC, once among the flabbiest of state-owned monopolies, is today hailed as a trendsetter.

In a sign of how tough times have become for the electric utilities, the first of a new round of rate cuts, some as much as 4%, began yesterday. And some water companies have promised refunds if their rate-setting methods are found to have skirted regulations. Even so, most analysts expect the utilities and their investors to get hit hard.

Mr. Littlechild, who is also the government's electricity regulator, says he is considering changing the regulatory setup for Britain's 12 regional electricity companies, privatized in 1990. The rate system, set last August, called for price cuts of as much as 18% beginning in April, and it limited future rate increases to annual inflation minus two percentage points.

Now, Mr. Littlechild says he is considering toughening the formula or even forcing the companies to refund money to their customers, a move that analysts say could cost the industry as much as £2.3 billion ($3.67 billion).



"What he's done has blown a hole in the system," says Tony Gilland, an analyst at the Center for the Study of Regulated Industries in London. "People are now seeing the free market as the cause of our problems."

In the week since Mr. Littlechild first hinted that changes are planned, utility-company stocks tumbled by nearly 6%. Shares of the regional electricity companies, which would be most affected by Mr. Littlechild's moves, have been hit the hardest, losing nearly 23% of their value. (Even that hit is only half of the gain the companies have seen in the value of their stock since privatization.)

The companies themselves are shell-shocked. "We thought everything was settled and sorted out," says Caroline Whittle, a spokesman for Midlands Electricity, which serves 2.2 million customers in central England. "Last year, we supplied all the information we could. The books were opened. So we were quite surprised when [Mr. Littlechild] said he planned to reopen the whole thing."

Privatization programs were conceived during the free-market heyday of the late 1980s. The United Kingdom moved quicker than any country to turn its state-owned electricity, gas, telephone and water industries over to private hands. The rigors of the market firmed up flabby state-owned companies, and the entire economy benefited from the massive sell-off.

The system seemed to strike a perfect balance. Ratepayers were protected by government controls over how much the companies could charge, while the companies were free to keep whatever profits they could make by cutting costs and boosting productivity.

For the utilities and their investors, the setup was a dream. Unlike many parts of the U.S., where utility profit margins are set by regulators, the U.K. system offered unlimited reward. By cutting fat and boosting productivity, the utility companies were hugely profitable.

Between privatization in 1990 and the end of 1994, profits for the regional electricity companies more than doubled, according to the Center for the Study of Regulated Industries. At some water companies, profits nearly quadrupled.

Though Mr. Littlechild says he knew of those gains when he agreed on a plan for electricity rates in August, he was still comfortable that the system was working. It wasn't until late last year, when Trafalgar House PLC launched a takeover of Northern Electric PLC, a regional electricity company, that his faith was shaken. Though Trafalgar offered to pay £1.2 billion for the company, Northern Electric argued that the bid was too low and launched a counterattack to persuade its shareholders to reject the deal.

The sweetened Northern package included £500 million in perks for shareholders, money that Mr. Littlechild didn't even know Northern Electric had.

That shock, as well as new evidence of hefty bonuses for many utility executives, prompted Mr. Littlechild to wonder if he had been too easy on the companies, and whether all of the companies had been honest about their finances when the current rate package was drawn up.

Andrew Horne, corporate affairs manager for Northern Electric, acknowledges that the episode has only fed a public perception that shareholders have triumphed over ratepayers under the current system. "For the next several months, there's going to be a fair amount of uncertainty," he says. "Customers can probably expect cuts in some form."

Attachment 4

The Olympian

LEGISLATURE

A8 WEDNESDAY APRIL 5, 1995

POLITICAL EDITOR:
MINDY CHAMBERS / 753-1

House endorses U S West protection

■ Turnabout bill: Until the company is allowed to compete nationally for long-distance custumers, backers say U S West should keep its regional advantage.

The Associated Press

A proposal to preserve U S West's hold over Washington's long-distance telephone market won House passage and was sent to the governor on Tuesday.

The measure, Senate Bill 5156, passed despite fierce lobbying from AT&T and MCI, which argued that telephone consumers would lose if national carriers were not allowed the same access to the instate market enjoyed by U S West.

"Consumers are taking a back seat to U S West," said Richard Severy, an MCI spokesman.

U S West contends that without the legislation, it would lose revenue and be forced to raise long-distance rates.

Specifically, the bill would bar the state Utilities and Transportation Commission from allowing national carriers to offer the simple "1-plus-area code" access numbers that U S West customers use for instate calling. The national carriers could continue to offer longer, more complicated access codes, which they contend cost them business.

If signed by Lowry, the law would remain in effect for three years or until Congress sees fit to let U S West compete in the national long-distance market.

Backers of the measure cited U S West's inability to compete as reason enough to vote for it. The bill passed 87-10.

Fred Hellberg, Lowry's aide on telecommunications issues, said the governor had taken no position so far. Severy said national carriers would lobby Lowry to veto the bill on grounds it is anti-consumer and because the issue should be left to the UTC to decide.

In floor debate Tuesday, foes said the bill was simply a way for U S West to enjoy a nearly competition-free market.

"This issue should be up to Utilities and Transporta Commission," said Rep. Ken Ja sen, D-Seattle. "What we're doi saying we don't want change don't want competition and carrier can have a monopoly."

But Rep. Julia Patterson, SeaTac, countered that the merely maintains the status She and others said the mea would be lifted if Congress allo U S West to compete for a nati market.

Regulatory Assistance Project

Attachment 5

Issuesletter

Stranded Costs

and Other Risks to Look Out For

Today's regulators, particularly those in states with high electricity prices, face calls for increased competition in the electric utility industry and a very full plate of new issues. Deciding what kind of competition makes sense and how to get there is an enormous challenge. Often, the debate is over whether retail competition — that is allowing customers to shop for generation — provides any advantage over wholesale competition among generators. But first there is a more basic question.

At the heart of nearly any competitive option is the problem of stranded costs. In general terms, stranded costs represent the difference between today's retail electricity prices and the current market price for power – a difference that today is very large in many states. What stranded costs are and how they should be handled lie at the center of any discussion of restructuring the electric industry.

This Issuesletter defines and describes, at least conceptually, how to measure stranded cost; illustrates that disposition of stranded cost is at the core of every response to competition, including retail wheeling, flexible pricing and special contracts; and discusses the risk allocation implications of each of these responses.

What Are Stranded Costs?

THE PRIMARY CONCERN at this time is not about costs that have been stranded but about costs that are at risk of becoming stranded in the future. Therefore, the term strandable, as opposed to stranded, better describes this issue. With a few exceptions, nearly all of these costs are currently in rates. Whether or not a strandable cost actually becomes stranded depends on actions that utilities, customers and regulators take. Many of the issues before regulators today involve decisions that may create stranded costs. It is only in cases where stranded costs are created that regulators must decide what they are and who pays. The shareholders? The customers? Which customers?

Breaking down the definition of strandable costs makes the concept easier to grasp.

Step 1

BY DEFINING STRANDABLE COSTS as the maximum amount of money that the utility is now collecting that is at risk, they can be calculated quite simply as the difference between what the utility now charges a customer minus any cost it avoids if the customer is no longer served.

Example 1: Assume an industrial customer now pays the utility $1 million per year for service. If the customer moves the factory to another state, the utility's annual revenues go down by $1 million. But the utility's costs also go down. Assuming fuel savings reduce the utility's costs by $600,000, $400,000 per year would be left stranded. It will be up to regulators to decide how these costs should be recovered.

Step 2

SUPPOSE THE CUSTOMER does not move the factory but instead takes advantage of retail wheeling and chooses a different supplier. Because the customer continues to be connected to the utility, she will continue to pay some reasonable charge to use the local utility's transmission and distribution system. Now the strandable costs are the difference between what the utility currently charges a customer minus any cost it avoids if the customer is no longer served minus any charges for residual services, such as transmission and distribution.

more ▸

March 1995

Example 2: If the same customer leaves the utility through retail wheeling and pays the utility $100,000 per year for transmission and distribution (T&D charge), the strandable cost drops to $300,000. (The original $1 million less the combination of fuel savings and transmission and distribution services.) Regulators will be asked to decide who will pay for these costs in the future.

Step 3

THE ELEMENT OF TIME, unfortunately, makes the second definition incomplete. The definition is correct and reasonably accurate for the first year. But what about years two, three...? Adding the element of time not only leads to the full definition of strandable costs, but it also exposes its most difficult issues. These are the uncertainties of calculating the number and the risks of getting the number wrong. By taking the time element into consideration, this third definition defines strandable cost as the present value of the difference between what the utility would have charged the customer over time minus any cost it avoids over time if the customer is no longer served (this is also the market value of power over the same time period) minus any ongoing utility charges for residual services.

The Regulatory Assistance Project

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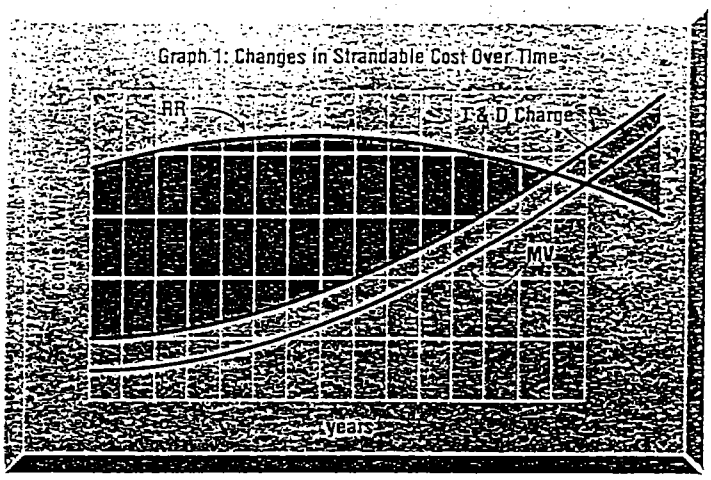
The Regulatory Assistance Project (RAP) provides free, in-house workshops for state public utility regulators. We are funded by the U. S. Department of Energy, the U. S. Environmental Protection Agency, The Pew Charitable Trusts and The Energy Foundation to provide this assistance to regulators.

RAP workshops examine electric utility policy issues from the perspective of the utility regulator. Our workshops are individualized for each commission, reflecting the needs and interest of the commissioners and staff of each host state.

We welcome ideas for future Issuesletters.

Example 3: The customer is a retail wheeling customer now and for the next 20 years. By using the equation from example 2, a yearly stranded cost determination can be made. The shaded area of the graph 1 below shows these year by year stranded costs, both positive and negative.



An examination of what the lines represent illustrates the complexity of calculating stranded costs over a number of years.

Revenue Requirements (RR)

THE MOST FAMILIAR PART of the graph, the line labeled RR, is the revenue requirements per kWh. This line, as will be seen in subsequent graphs, is the same as the average retail rate. Two issues arise when estimating this line into the future.

1. Forecasting load, fuel costs, interest rates, inflation and all of the other parts of the revenue requirement is inherently risky. Even the best crystal balls are never perfect.

2. Forecasted revenue requirements means estimating costs associated with today's service that are not yet in rates. Examples include the future costs of existing power purchase commitments, deferred costs of all sorts, the costs of unfunded nuclear decommissioning, waste storage and salvage value of plants and sites. If today's customers remain with the utility, they would be expected to share these costs and revenues at a later date. By leaving, their share of these unknown costs and revenues are strandable.

Market Value (MV)

THE LINE labeled MV looks familiar because it has the same shape and level as avoided cost projections. This is not a coincidence. For all practical purposes, market value and avoided cost are the same. However, while these terms can be used synonymously, market value has a very different use than avoided cost. It is this use that makes the task of determining market value and the consequences of getting it wrong much more daunting.

1. Avoided cost typically places a value on small additions to the existing generation system. For many policy choices now under consideration, market value for estimating strandable costs, sets a value for the entire system – both existing and new generation. If the avoided cost for a 50 MW resource addition is off by $1/KW, the mistake will be a contained one. But when calculating strandable costs, the impact of the same error, because it applies to the entire system, will be much greater.

2. With avoided costs, it is possible to limit consideration to resource options within the utility's control. Market value calculations, on the other hand, require forecasting a value for generation in the context of a much larger, deregulated regional market. If the market mechanisms needed for a regional generation marketplace existed (power pools, open access transmission and structural reforms that eliminate affiliated transactions or market power), these forecasts would be difficult enough. However, since these market mechanisms do not exist, market value forecasts are made with very limited information and understanding.

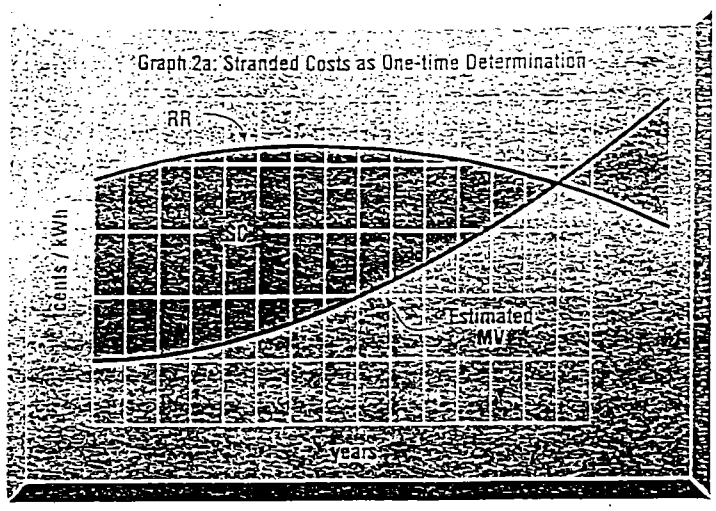
Stranded Cost (SC)

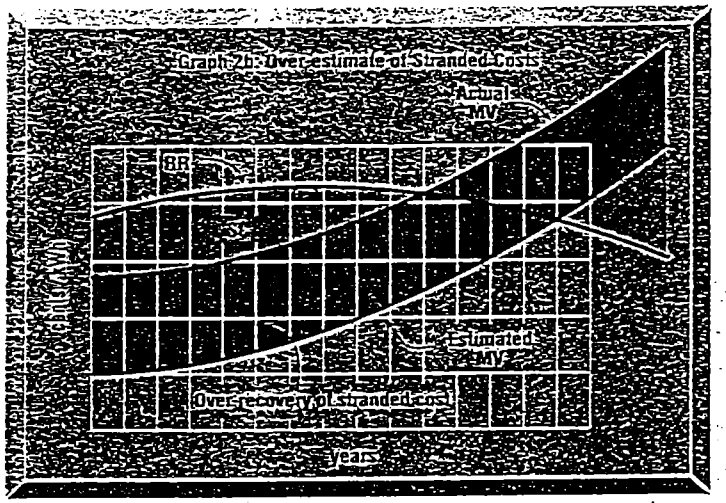
THE CALIFORNIA PUC's first attempt at defining stranded cost reveals the enormity of the risks associated with the policy options under consideration. In its original vision (the "Bluebook"), the California Commission proposed a policy course which included identification of strandable cost as a first step in deregulating generation and giving all customers direct access to generation priced at market value. To do this, they proposed a regulatory proceeding that would quantify stranded costs and allow utilities to recover that amount through competition transition charges (CTC). The CTC is calculated based on the commission's best estimate of stranded cost (the shaded area), including its estimate of the market value of generation resources.

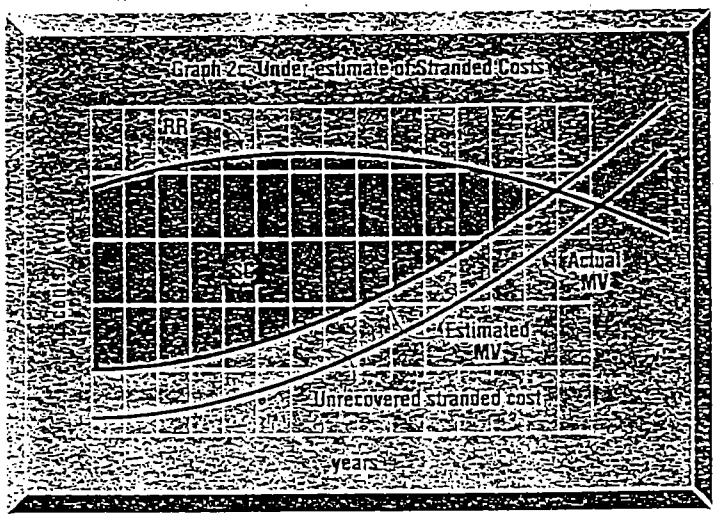
Consider what happens if the actual market value – the price customers pay for electricity – turns out to be different than the commission's original estimate. The following sequence of graphs shows what can happen.

The first graph, 2a, shows the SC that would be the basis of a one-time determination of the CTC.

Graph 2b shows what happens if, after the CTC is determined, gas prices rise higher than expected. Market value rises significantly, revenue requirement (that is the gas-fired portion of the utility's fuel mix) rises very modestly and stranded costs are essentially eliminated. (Note that for the purpose of clarity, these illustrations show an unchanged RR line.) But under California's original vision, the original CTC remains, and the customer pays the higher market price. In other words, customers pay the double-shaded area twice, first in the CTC, then in their power purchase.







Graph 2c shows what happens if gas prices fall below forecasts. Customers pay a low market price for generation and a CTC that leaves some stranded costs (unshaded area) uncovered.

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Flex Rate Minefields

Are they legal?

Commissions are expected to set non-discriminatory rates. Discounting rates for a few customers may discriminate against customers who did not receive a special deal, particularly those who compete with the customer receiving the discount.

Who knows if claims are legitimate?

While there is every incentive for a customer to argue hard for a discount (and even bluff), commissions typically lack detailed knowledge about the customer's business because customers are reluctant to fully divulge sensitive information to commissions. Imposing revenue losses resulting from discounts onto the utility is the main tool used by regulators to transfer the burden of proof from the regulators to the utilities. This move also gives the utility an incentive to offer as small a discount as possible.

While in theory this is a logical step, there are two reasons to be skeptical about this solution. First, this is an easy policy to implement when discounts are awarded between rate cases, but it is very difficult, if not impossible, to assure that revenue loss will continue to be allocated to shareholders once the utility files its next case. Second, if the utility is (or would otherwise be) overearning, requiring shareholders to absorb these revenue losses merely takes what would be a rate reduction for all customers and allocates it to a small class of customers. This means that adopting special rates on a case-by-case basis will result in inconsistencies with rate design.

The consequences of mistakenly granting a deal are small.

Refusing to approve special deals is risky for commissions. If they wrongly deny a flex rate and a large employer leaves the state, they may be blamed. Conversely, if they mistakenly approve a deal, the error will never surface. Granting the special contract is even easier if regulators believe utility shareholders will pay the revenue loss. But as described above, this may be a easier said than done.

Rate discounts offered to one customer will be sought by others.

Once commissions say yes to one customer, they might find themselves on a slippery slope where it gets increasingly difficult to say no to subsequent requests.

What is the net impact on jobs?

If flex rates result in raising the rates of other customers, those customers will become less competitive. The number of jobs created (or maintained) by offering a low rate to one customer may be offset by jobs lost from other customers who are paying more.

Flex rates are anti-competitive.

Special rates are potentially both discriminatory and anti-competitive. By offering uneconomically low rates to customers with legitimate competitive alternatives, a utility squeezes out competition. This is never desirable, particularly if other customers are subsidizing the discount.

Points Not To Forget

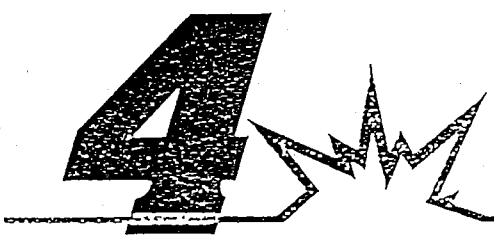
THE EXAMPLES ABOVE illustrate two fundamental points. The first is that because there is a great deal of uncertainty surrounding strandable cost determination, even the best and most unbiased attempts will produce a number that will be wrong. What is not known is by how much and in what direction the error will fall. (For a medium to large electric utility, errors of several $100 million are possible.) Second, how customers, shareholders and utilities are exposed to the consequences of errors in stranded cost determination depends entirely on the form, pace and scope of policy choices made by regulators.

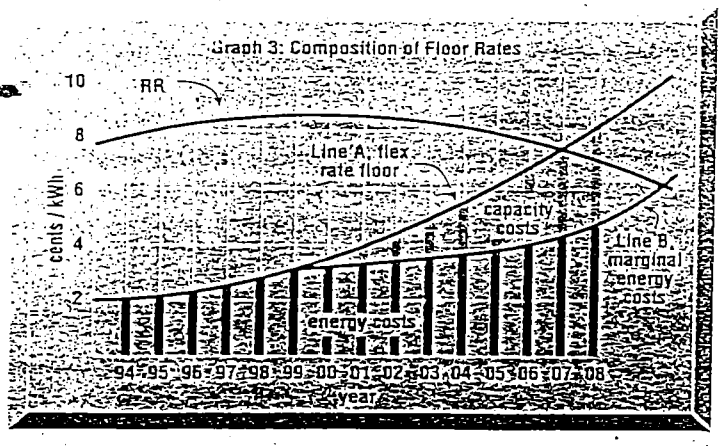
Policy Responses To Competition

REGULATORS ARE CONSIDERING a wide choice of policy responses to increased competition. This section looks at two frequently considered responses and evaluates what competitive benefit they offer, how they handle strandable costs and how risks are affected.

"Flex" Rates and Rate Design Solutions

WITH INCREASING FREQUENCY, commissions are being asked to approve special rate discounts (sometimes called economic development rates) for large industrial customers to attract new customers, encourage expansion or to retain customers who threaten to close their plant, move it to a different service area or self-generate. In theory, discounted rates, load retention and cogeneration deferral rates aim at setting rates that cover short run fuel costs, plus some contribution to fixed cost. While hypothetically this pricing is competitive and contributes to fixed costs, in reality, pricing on this basis may yield prices lower than what competitive markets would charge and in doing so exacerbate, not improve, stranded cost recovery.





Graph 3 illustrates why the stranded cost problem can be aggravated with flex rates that assume a short run marginal cost price floor.

Here, a marginal cost line replaces the market value line. The area under the line is further divided to show the portion of marginal costs that covers fuel (dark green bars) and the portion that covers future capacity costs (lighter green bars). (For the sake of simplicity, all the area shown as capacity is the annual capital cost of a new baseload plant added in 2000). The line labeled A represents the price the customer would pay if she were to make no contribution to stranded cost. Any rate set below line A increases stranded costs because the utility (or other customers) must absorb the added capacity costs.

Flex rate contracts typically run for short periods of time – one to three years. Graph 3 shows that from 1994 to 1999, the flex rate floor (line A) is the same as the marginal cost. However, during this period planning and investment decisions are typically made under the assumption that the utility will continue to serve the customer well into the future. In this case, new capacity is added in 2000.

In 2001, the customer may again seek a special deal based on the same economic principles applied in 1994. However, the new plant, together with its capital costs (sunk as of 2000), have changed the economic picture. Now, line B reflects the marginal energy costs (including the fuel for the new plant). If the customer is allowed to pay only the energy costs, the cost of adding capacity is borne by shareholders or other customers. As the graph shows, charging prices that follow line B rather than line A increases the stranded costs. Not charging for capacity additions also raises doubts about any assertion that flex rate policies are consistent with competitive pricing.

If, despite these issues, commissions decide to grant flex rates, these rates must, at a minimum, recover marginal fuel costs, capacity investments and transmission and distribution charges and should include as much of the strandable cost as possible. In addition, contract terms should specifically notify customers that either no capacity additions are being planned for them, thereby making them responsible for the full incremental costs of service in the future or that capacity additions are being planned, and that they are responsible for covering the costs in the future.

Either of these protective measures will work in theory. Both, however, rely on ongoing enforcement which will vary from state to state and from time to time.

Retail Wheeling

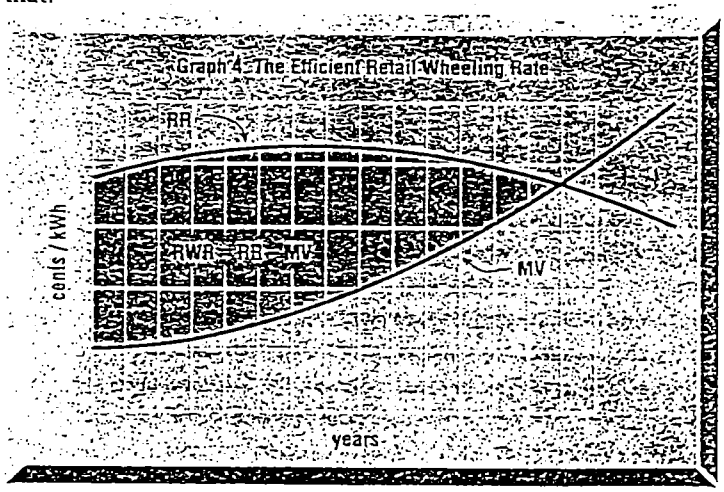
ANOTHER POLICY OPTION commissions face is retail wheeling. Under this scenario, a utility's generation, transmission and distribution services are unbundled. Customers shop for their own generation and pay a wheeling rate for use of the wires. This option, if implemented and structured correctly, has the ability to offer both competitive benefits and recover stranded costs. Its success hinges on setting the right retail wheeling rate (RWR).

Graph 1 illustrated the relationship between stranded cost and a retail wheeling (or T&D) rate. In that example, the RWR was shown as the transmission and distribution charge at an arbitrary rate of 1¢/kWh, an assumption now revisited. As already discussed, the revenue requirement and market value lines are quite uncertain. While regulators may be called upon to forecast what these lines look like, they have no meaningful ability to control their actual values. For all practical purposes then, these two determinants are uncontrollable by regulators. The third factor, however, the wheeling rate, is completely controllable. The RWR results in no stranded costs when calculated as the retail rate minus the avoided cost or market value:

$$RWR = RR - MV$$

Graph 4 shows how this equation results in no stranded costs.

This determination also supports economic efficiency. The argument for retail access is that it gives customers an opportunity to lower overall costs. This occurs when customers are able to acquire resources at a cheaper price than the utility. The RWR calculation gives customers economic price signals to do just that.



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The Regulatory Assistance Project
177 Water Street
Gardiner ME 04345-2149

Shoppers Tariff To Calculate Ongoing Market Value

The Shoppers Tariff calculates a market value for power on a monthly basis. Using this system, a customer getting electricity from another supplier receives a monthly bill from her original local utility as if the utility was continuing to provide her all services. However, subtracted from the bill is a rebate representing the amount the utility saves (administration, fuel and any incremental generation costs) by not having to provide power to the customer. The customer uses this credit to shop around for an alternative (and hopefully cheaper) source of power. Rebating the customer only the amount saved by not having to serve her, means that there is no shifting of costs onto the remaining customers.

For example, assume a retail rate of 5¢ and the utility's avoided or marginal cost of serving the customer is 2¢. If the customer chooses a 3¢ alternative supplier, the decision is uneconomic. Using flex rates, the ordinary response would be to lower the 5¢ rate to somewhere between 2–3¢ so the customer will decide against the uneconomic, 3¢ option. In the context of retail wheeling, the RWR provides the tool to produce the same result. A 3¢ RWR rate discourages the customer from selecting the 3¢ option but encourages her to beat the 2¢ marginal cost of the utility.

Some Stranded Costs Can Still Be Apportioned To The Utility

SETTING A RWR does not preclude a commission from asking utilities to assume some of their strandable costs. What it does prevent is having utilities or other customers absorb only those stranded costs from customers who leave. If a regulator wants a utility to write off a portion of the stranded costs, it should be done as a principled policy decision that lowers the retail rates of all customers. The RWR would then be calculated after such a decision is made.

Parting Thoughts

THIS ISSUESLETTER looks at only two policy responses to competition currently before commissions. Unless done properl these approaches carry not only the risk of shifting costs and allowing consumers to make uneconomic decisions but also the risk of stranding benefits, such as environmental protection, energy efficiency and long term planning by utilities. While estimates of the dollars at risk from stranded costs vary, it is clea that a swift move from existing revenue requirements to the current depressed market prices would severely injure many (perhaps most) utilities and could bankrupt some.

There is, however, widespread recognition that fully competitive markets for electricity generation are desirable and will lead to significant productivity gains. There are two directions utilities and regulators might take, each of which has its drawbacks. The first waits for stranded costs to disappear as existing high cost utility plants depreciate, power purchase contracts lapse and excess capacity is utilized. There is a good chance that during this time, market prices will rise as supply and demand for generation move into balance. This wait-it-out strategy is embraced by many utilities and is a driving force behind special rate deals, but if it works at all, it will work slowly.

The other choice is to seek mechanisms to deal directly with stranded costs while simultaneously restructuring the industry and its regulation. Indeed, while many see stranded costs as the primary obstacle to competitive generation, others see it as the critical and, until now, lacking leverage to move toward increased competition. Getting competitive generation is not easy and will require industry restructuring in ways that regulators cannot impose against the will of utility managers. Because stranded costs come under regulatory control, dealing with them may provide the needed catalyst for productive change. ■

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Washington Water Power

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April 27, 1995

Washington Utilities & Transportation Commission
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Olympia, WA 98504-7250

Attention: Steve McLellan, Secretary

Re: Docket No. A-940932, Examining Regulation of Electric Utilities in the Face of Change in the Electric Industry

The Washington Water Power Company has reviewed the 37 sets of comments received by the Commission in the above-noted docket. Our reply comments are as follows.

Commentors reflect a wide range of opinion on current trends and future regulatory issues. In combination with existing WUTC principles, these comments provide a good backdrop as the Commission proceeds in this examination of industry change. While the array of opinion appears to be broad, we are hopeful that several shared principles will be reaffirmed and some common views of future regulation will be attained.

WWP has no further observations to add to our initial written comments at this time. We look forward to discussing our perspectives and responding to other parties' issues and concerns at the upcoming workshops.

Sincerely,

Thomas D. Dukich

Thomas D. Dukich, Manager
Rates and Tariff Administration