May 13, 2005

Carole J. Washburn
Executive Secretary
Washington Utilities and Transportation Commission
1300 South Evergreen Park Drive SW
P.O. Box 47250
Olympia, WA 98504

Re: Comments of the Natural Resources Defense Council in Docket Nos. UE-030311, UG-0303312, and UE-030423

Dear Ms. Washburn:

On behalf of our 24,070 members residing in Washington, the Natural Resources Defense Council (NRDC) submits these comments on the draft rules in Docket Nos. UE-030311, UE-030312 and UE-030423. We hope also to participate in the Commission's June 9 workshop on these issues, and we submitted earlier comments in these dockets on May 6, 2003.

When the Commission released the Notice of Opportunity to File Comments in these dockets more than two years ago, NRDC commended the initiative and encouraged the Commission to address three principal obstacles to successful least-cost planning and procurement by the state's UTC-regulated utilities: (1) potent financial disincentives for cost-effective conservation associated with the linkage of utilities' financial health to retail energy consumption; (2) a lack of any performance-based incentives for long-term resource procurement, including but not limited to cost-effective conservation; and (3) omission from long-term resource procurement of any allowance for increasingly obvious financial risks associated with greenhouse gas emissions. We offered specific recommendations in all three categories:

> (1) To remove a powerful conservation disincentive, the Commission should endorse the adoption, statewide, of a simple system of periodic true-ups in electric rates, designed to correct for disparities between utilities' actual fixed cost recoveries and the revenue requirement approved by the UTC. The true-ups would either restore to the utilities or give back to customers the dollars that were under- or over-recovered as a result of annual throughput fluctuations, based on test-year target revenues per customer.
>
> (2) Introduce performance-based incentives for sound long-term resource portfolio management: at best, today, resource procurement looks to management like a passthrough proposition, with some downside potential.

www.nrdc.org

111 Sutter Street, 20th Floor
San Francisco, CA 94104
TEL 415 875-6100 FAX 415 875-6161

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For Puget, for example, failure to meet conservation targets earns a penalty, but there is no reward for beating targets (and indeed, automatic shareholder penalties accompany any energy efficiency improvements, in the form of reduced recovery of the utility's fixed costs). And shareholders earn nothing from adroit renewable energy procurement that cost-effectively reduces customers' exposure to volatile fossil fuel prices. **What is most urgently needed now is strong emphasis from the Commission itself on the importance of providing better portfolio management incentives, and specific timetables and procedures for creating them.** Puget alone has an annual electricity procurement budget on the order of $900 million, covering about 20 billion kWh in combined annual generation and conservation acquisitions.

(3) The Commission should require the use in least-cost plans of imputed costs for carbon dioxide emissions at least equal to those already adopted in PacifiCorp's latest IRP;

Two years later, the Commission has finally issued draft rules in response to these and other comments and a June 2003 workshop. We concur with our colleagues at the Renewable Northwest Project that the draft IRP rules contain desirable features, including the introduction of the concept of "lowest reasonable cost" and specific incorporation of "market volatility risks of generating and demand-side resources."[1] The draft rules for both electricity and gas IRP also maintain Washington's traditional emphasis on energy efficiency, although we encourage the Commission to apply to both electricity and gas the more comprehensive approach recommended in the gas rule.[2] The Commission clearly intends, but should make more explicit, that it expects utilities to undertake and regularly update assessments of all potentially cost-effective energy efficiency improvements in all sectors of electricity and natural gas use.

We are extremely disappointed to find no reference in the IRP rules to any of the issues raised in our initial comments. Financial risks from greenhouse-gas emissions are ignored, as is the importance of performance-based incentives for improved integrated resource planning and the removal of disincentives for cost-effective conservation. The draft rule on power purchases does include in its "ranking criteria" for project proposals "environmental effects including those associated with resources that emit carbon dioxide."[3] But the rule provides no guidance on how to do this, and the "environmental effects" are specifically and inappropriately distinguished from "risks imposed on ratepayers," which are treated as a separate criterion. The Commission should make clear that emissions of carbon dioxide are themselves significant "risks imposed on ratepayers," given the increasing likelihood of regulatory

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[1] "Lowest reasonable cost" is defined in WAC 480-100-238(2)(b) and WAC 480-90-238(2)(b) (note that the word "cost" was inadvertently omitted in the gas rule version); "market-volatility risks" are addressed in the same sections.

[2] The gas rule calls for "an assessment for each customer class of the technically feasible improvements in the efficient use of gas", whereas the electricity rule uses less exacting terminology ("an assessment of technically feasible improvements in the efficient use of electricity").

[3] WAC-480-107-035 (2).

limits on emissions. We join our RNP colleagues in calling on the Commission to join its California colleagues by directing utilities, when evaluating resource proposals, to assign specific dollar values to carbon dioxide emissions associated with long-term resource acquisitions: a levelized cost of $8 per ton of CO_2, based on a cost stream of $5 per ton CO_2 in the near term, $12.50 per ton CO_2 by 2008, and $17.50 per ton CO_2 by 2013.[4]

Finally, we continue to urge the Commission to address the pathologically misaligned incentives that now distort resource procurement by all Washington utilities. A clear objective of these draft regulations is to ensure that conservation can compete on equal terms with generation, but this will remain an empty promise as long as utilities automatically lose money on cost-effective energy efficiency investments. As NRDC's expert witness noted in the most recent PacifiCorp rate case:

> The regulatory status quo undercuts sound resource portfolio management by penalizing utility shareholders for reductions in electricity throughput over the distribution system, regardless of the cost-effectiveness of any contributing energy-efficiency, distributed-generation or fuel substitution measures. From customers' perspective, increases in throughput (above those contemplated when rates were established) result inappropriately in an uncompensated over-recovery of fixed costs by their utility. And from a least-cost-planning perspective, a grave if unintended pathology of current ratemaking practice is the linkage of utilities' financial health to retail electricity throughput. Increased retail electricity sales produce higher fixed cost recovery and reduced sales have the opposite effect. **My testimony includes a demonstration that a reasonably aggressive five-year energy efficiency investment program in its Washington service territory would automatically inflict almost $19 million in losses on PacifiCorp's shareholders, regardless of the cost-effectiveness of the electricity savings.** To address all these problems, I recommend that the Commission adopt a simple system of periodic true-ups in electric rates, designed to correct for disparities between the Company's actual fixed cost recoveries and the revenue requirement approved by the Commission in this proceeding. The true-ups would either restore to the Company or give back to customers the dollars that were under- or over-recovered as a result of fluctuations in retail electricity sales.[5]

Comparable recommendations appear in the 2005 Focus on Energy report of Northwest Environment Watch.[6] As long as the Commission neglects this issue and the related question of performance-based incentives, prospects will remain dim for the regulatory goal of meeting system needs "with a lowest reasonable cost mix of

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[4] California Public Utilities Commission, D.05-04-024, "Interim Opinion on E3 Avoided Cost Methodology," April 7, 2005, Conclusion of Law 7.

[5] Direct Testimony of Ralph Cavanagh, Washington UTC v. PacifiCorp, Docket No. UE-032065 (June 29, 2004), pp. 2-3.

[6] Cascadia Scorecard: Seven Key Trends Shaping the Northwest – Focus on Energy 2005, pp. 55-57.

resources." We appreciate the opportunity to comment and look forward to continued engagement on these crucial issues.

Yours sincerely,

Ralph Cavanagh

Ralph Cavanagh
Northwest Energy Project Director