

**COMMENTS OF THE NATURAL RESOURCES DEFENSE COUNCIL
ON THE WASHINGTON UTILITIES AND TRANSPORTATION
COMMISSION'S REVIEW OF ITS LEAST-COST PLANNING AND
PROCUREMENT RULES
[DOCKET NOS. UE-030311 & UE-030423]**

submitted by Ralph Cavanagh, Northwest Energy Program Director
May 6, 2003

On April 18, 2003, the Washington Utilities and Transportation Commission released a Notice of Opportunity to File Written Comments in Docket Nos. UE-030311, Least Cost Planning Rulemaking, WAC 480-100-238, and UE-030423, WAC 480-107. On behalf of our 21,400 Washington members, the Natural Resources Defense Council (NRDC) submits these comments, and looks forward to participating in the Commission's June 13 Workshop.

NRDC strongly supports this review and commends the Commission for conducting it. At the outset, we also note and endorse the compelling comments of the Northwest Energy Coalition. Our focus below is on ways to remove the most significant obstacles to successful least-cost planning and procurement by Washington's UTC-regulated utilities.

I. FIXING MISALIGNED RESOURCE ACQUISITION INCENTIVES

A. THE PROBLEM

One of Washington utilities' most important responsibilities involves what NRDC has called "electric-resource portfolio management": assembling a diversified mix of demand- and supply-side resources designed to minimize the societal costs of reliable electricity supplies. This goes to the heart of the least-cost planning enterprise described in WAC 480-90-238. But the regulatory status quo undercuts sound portfolio management in at least two respects: (1) it makes no provision for a balanced system of rewards and penalties tied to utilities' overall performance as resource portfolio managers; and (2) it penalizes utility shareholders for reductions in electricity throughput over the distribution system, regardless of the cost-effectiveness of any contributing energy-efficiency or fuel substitution measures.

NRDC and NWEC raised these issues forcefully during the latest Puget rate case, and the Settlement Stipulation (which we joined) includes the following statement (Settlement Terms for PCA, Items 16& 17, p. 7):

“One of Puget Sound Energy’s important responsibilities involves electric resource portfolio development, a responsibility addressed in the Company’s least cost plans pursuant to WAC 480-100-238. This includes, among other things, assembling a mix of demand- and supply-side resources that promotes the societal benefits of reliable least cost electricity supplies. The parties agree that PSE’s least-cost planning process provides an appropriate forum to address the evaluation of PSE’s portfolio development, including consideration of rewards and/or penalties tied to PSE’s overall long-term performance in portfolio development. The parties recommend that the Commission address these issues as soon as possible in Puget’s least-cost planning process, pursuant to WAC 480-100-238, with opportunities for public comment prior to final determination.

Nothing in this settlement precludes any party from raising in an appropriate future Commission proceeding issues surrounding the decoupling of distribution fixed cost recovery from retail sales volumes. The parties have reached no consensus on what constitutes an “appropriate proceeding” for this purpose, and reserve the right to oppose any effort to raise such issues.”

In short, the Puget settlement acknowledges these crucial issues but does not attempt to propose a resolution. Yet the stated hope of the parties was that “as soon as possible” the Commission would take up the matter of incentives for long-term performance on portfolio management, within the context of the UTC-supervised least-cost planning process. This workshop creates a crucial opportunity for the Commission to advance the discussion and to consider alternative ways of moving toward the “final determination” on portfolio-management incentives that was anticipated but not achieved in the Puget stipulation.

B. REMOVING DISINCENTIVES FOR CONSERVATION

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. To remove a powerful conservation disincentive, we propose that the Commission 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.

Our proposal would revive key elements of a per-customer revenue cap mechanism adopted by the Commission in 1991 for Puget. As the Commission determined at that time:

[T]he revenue per customer mechanism does not insulate the company from fluctuations in economic conditions, because a robust economy would create additional customers and hence, additional revenue. Furthermore, the Commission believes that a mechanism that attempts to identify and correct only for sales reductions associated with company-sponsored conservation programs may be unduly difficult to implement and monitor. The company would have an incentive to artificially inflate estimates of sales reductions while actually achieving little conservation.¹

We also propose that the UTC reinstitute procedures that it adopted in 1991 to implement Puget's original revenue per customer cap, by "set[ting] up a deferred account allowing a reconciliation of revenue and expenses that would be subject to hearing and review."²

The most recent regional experience with such a true-up mechanism came in Oregon with PacifiCorp's "Alternative Form of Regulation, which was adopted in 1998."³ California law now requires statewide adoption of similar systems for investor-owned utilities, and New York State has just begun a rulemaking on the issue.⁴ Rate impacts of the Oregon mechanism are summarized in Appendix I below; NRDC will advocate its renewal in the brand new PacifiCorp General Rate Case in Salem.

C. PERFORMANCE-BASED PROCUREMENT INCENTIVES

More than a decade ago, the National Association of Regulatory Utility Commissioners (NARUC) determined that traditional regulation affords utilities little incentive to be good portfolio managers. The response was a recommendation to "ensure that the successful implementation of a utility's least-cost [investment and procurement] plan is its most profitable course of action."⁵ The resolution framed the term "least-cost" in life-cycle terms. Congress endorsed NARUC's objective in the National Energy Policy Act of 1992, for both electric and gas utilities, although the final decision remains with state utility regulators.⁶

Regulation in Washington fails this test. Nothing like performance-based incentives for sound long-term portfolio management exists today; at best, resource

¹ Docket No. UE-901183-T, Third Supplemental Order (April 10, 1991), p. 10. The Commission also determined that the mechanism did not constitute retroactive ratemaking, and that it was "fair, just and reasonable" even though it did not perfectly match costs and rates: "even under the current system of ratemaking, costs and rates will diverge immediately following implementation of a rate change." *Id.* at p. 10.

² *Id.*, at p. 10.

³ Oregon PUC, Order No. 98-191 (May 5, 1998) (covering 1998 – 2001).

⁴ See California Public Utilities Code section 739.10; New York Public Service Commission, Order Instituting Proceeding, Case 03-E-0640 (Proceeding on Motion of the Commission to Investigate Potential Electric Delivery Rate Disincentives Against the Promotion of Energy Efficiency, Renewable Technologies and Distributed Generation (May 2, 2003)).

⁵ NARUC, Profits and Progress Through Least-Cost Planning, at 57 (November 1989) (from Resolution in Support of Incentives for Electric Utility Least-Cost Planning, adopted July 27, 1989).

⁶ See sections 111 and 115.

procurement looks to management like a passthrough proposition, with some downside potential. For Puget, for example, failure to meet conservation targets earns a penalty, but there is no reward for beating targets (and indeed, as noted in the previous section, 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.

Progress in solving these problems will continue to stall without Commission leadership, as the recent Puget rate case demonstrates. **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. And these issues certainly are not limited to Puget.

II. ADDRESSING FINANCIAL RISKS FROM CARBON DIOXIDE EMISSIONS

In exercising long-term resource procurement responsibilities on behalf of their customers, Washington's utilities must make decisions about long-term financial commitments to fossil generation, and the UTC has ultimate responsibility for guiding and judging these decisions. An increasingly important issue is the financial risk associated with future regulation of greenhouse gas emissions. We urge formal UTC recognition of these risks and the importance of assigning them appropriately.

The problem is best understood in concrete context: if a utility builds a coal-fired plant or signs a long-term contract with an existing or new plant, **who pays** if subsequent legislation, regulation or court decrees impose a cost on the plant's carbon dioxide emissions? The one answer that state regulators absolutely should not tolerate is silence, or language in a long-term contract or construction proposal that is intended to shift the risk invisibly to captive utility customers.

The potential magnitude of these financial risks is illustrated in PacifiCorp's recent Integrated Resource Plan, which includes an evaluation of the cost-effectiveness of fossil generation based on the assumption that carbon dioxide emissions will cost an average of about eight dollars per ton over the plant's lifetime (equivalent, for a 1000 megawatt coal-fired plant, to some \$60 million **per year** in cost exposure for utility customers).⁷ This represents PacifiCorp's best judgment based on a comparison of regulatory proposals and actions across North America and Europe; other estimates are substantially higher.⁸

⁷ PacifiCorp's [2002 Integrated Resource Plan](http://www.pacificorp.com) is available on the Company's website at www.pacificorp.com. The estimate of \$60 million in annual exposure assumes that the plant operates at an 85 percent capacity factor, and that it emits about one ton of carbon dioxide per megawatt-hour, yielding 7.5 million tons of CO₂ per year.

⁸ For example, the Energy Information Administration's analysis of one recent and widely publicized Senate bill, the Clean Power Act (S.556), estimated that CO₂ allowance prices in 2010 would range from

We recommend two specific responses from the Commission: (1) 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; and (2) insist that, in any resource procurement, utility customers be protected from the financial impact of any future regulation of carbon dioxide emissions, by shifting that risk explicitly to the sponsors of resources that create it.

We look forward to further discussion of these and related issues at the Commission's June 13 Workshop.

Respectfully submitted this 6th day of May, 2003



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APPENDIX I: RATE IMPACTS OF PACIFICORP'S TRUE-UP MECHANISM

In May of 1998, the Oregon PUC adopted a true-up mechanism similar in some ways to this proposal, as part of an Alternative Form of Regulation (AFOR) for PacifiCorp. Three annual true-ups occurred under the mechanism before it expired in July 2001 (no decision has yet been reached on its successor). Rate impacts of the true-ups were extremely modest for all classes, and went in both directions:

	1999	2000	2001
Residential:	-0.39%	+1.90%	+1.85%
Small General Service:	-0.60%	-0.22%	+0.06%
General Service:	-0.83%	-0.31%	+0.09%
Large General Service:	+0.61%	+0.33%	-0.30%
Irrigation:	+0.45%	+0.25%	-0.20%

[\\$13-\\$23 per ton of CO2 \(converted from \\$54-\\$93 per metric ton of Carbon in the original\). EIA publication SR/OIAF/2001-5.](#)