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PUGET SOUND ENERGY
The Energy To Do Great Things

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April 24, 2009

Mr. David W. Danner
Executive Director and Secretary
Washington Utilities and Transportation Commission
P.O. Box 47250
Olympia, WA 98504-7250

Subject: **Docket No. U-090222**
Review of PURPA Standards in the Energy Independence and Security Act of 2007
Comments of Puget Sound Energy, Inc.

Dear Mr. Danner:

Puget Sound Energy, Inc. ("PSE" or the "Company") appreciates the opportunity to participate in the Commission's examination of whether new regulations are needed to govern six aspects of investor-owned electric and natural gas utility operations for which new federal standards are included in the Energy Independence and Security Act of 2007, Public Law 110-140 (EISA). In response to the Commission's Notice of Opportunity to File Written Comments dated March 20, 2009 in Docket No. U-090222, PSE offers the following comments and suggested rule language.

COMMENTS

The following sections provide specific comments and suggested rule language in response to the questions posed in the Notice of Opportunity to File Written Comments. For ease of reading, the questions are reproduced below followed by PSE's comments.

I. PURPA Standards for Electric Utilities
A. Integrated Resource Planning

Question A.1. *Should the Commission, by rule, implement part B of PURPA Standard 16 establishing cost-effective energy efficiency as a priority resource?*

Comments:

No additional rules appear necessary. The IRP rule requires an integrated resource plan to show a least cost mix of conservation and energy supply resources. The Energy Independence Act, Ch. 19.285 RCW, requires utilities to acquire all cost effective conservation, providing deference to the Commission for reviewing and approving the targets.[1] Furthermore, RCW 19.285.060(4) specifically allows the Commission to adopt financial incentives to encourage better performance in acquiring energy efficiency resources. Therefore, current Commission policies already appear sufficient to identify cost effective energy efficiency as a priority resource.

Question A.2. *What is a "priority resource"?*

Comments:

With regard to energy efficiency, PSE interprets the term "priority resource" to mean energy efficiency programs that are part of the optimal mix of resources, balancing costs and risks. Thus, "priority resource" incorporates the concept of cost effectiveness. That is why PSE believes the current IRP rule, in conjunction with RCW 19.285 requirements to achieve cost effective conservation with the potential for financial incentives is sufficient.

Question A.3. *Does the term "priority resource" differ in affect from the requirement to pursue all cost-effective conservation?*

Comments:

No—please see above discussion.

Question A.4. *If establishing energy efficiency as a priority resource requires the acquisition of energy efficiency in aggregate that is above the cost effectiveness threshold, would its establishment as a priority resource conflict with any existing policy established in state law statute or regulation?*

Comments:

Yes. The Energy Independence Act states: "Each qualifying utility shall pursue all available conservation that is cost-effective, reliable, and feasible."[2] It appears that requiring the acquisition of energy efficiency resources beyond that level would conflict with RCW 19.285. Such a requirement may not be in conflict with the IRP rules. The IRP rules

[1] RCW 19.285.040 (1)
[2] RCW 19.285.040 (1)

define "lowest reasonable cost" to reflect public policies passed by Washington State, which would probably include WAC rules. Such a change, however, would require rules to make clear what level of energy efficiency resource acquisition is appropriate.

Question A.5. *If establishing energy efficiency as a priority resource does not mean pursuing additional energy efficiency above the costs effectiveness threshold, then how would it differ from current Commission regulation and policy?*

Comments:

As described above, the combination of IRP rules and RCW 19.285 already provide sufficient policy guidance to appropriately establish the priority of energy efficiency resource acquisition.

B. Rate Design and Modifications to Promote Energy Efficiency Investments (electric)

In our comments, we will use the two tests identified in Section 532(a) (17)(A) of the Energy Independence and Security Act of 2007: whether modifications to electric rate design (1) align utility incentives with the delivery of cost-effective energy efficiency, and/or (2) promote energy efficiency investments. In addition, we will address the Commission's considerations as to whether the rate design modifications encourage (3) conservation of energy supplied by electric utilities, (4) optimal efficiency of electric utility facilities and resources, and/or (5) equitable rates for electric consumers. Our comments will refer to the above as Test 1 through Test 5.

Question B.1. *Are there modifications to current utility block electric rate designs that could promote conservation? How would such modifications be implemented in a rulemaking?*

Comments:

In the effort to promote conservation rates can be set at levels that are too high, as well as too low. Rates that are set too high or too low distort retail prices, create incentives for inefficient use, and lower the value of electric service to customers. Thus, the use of utility block electric rate design to promote conservation, or more specifically cost-effective energy efficiency, puts a great premium on setting rates at the right level, which can be difficult. We believe any rate based solely on theory would be controversial.

While there possibly could be some modifications to current utility block electric rate design that promote cost-effective energy efficiency, altering rate blocks is an inferior way to address this important goal. In particular, in addition to the problem of setting the theoretically perfect rate, promoting energy efficiency investments through the use of modifications of current utility block electric rate design does not align utility incentives with the delivery of cost-effective energy efficiency (Test 1), since it will most likely make revenues more volatile and will increase the amount of net revenues lost. In addition, as

discussed below, modification of block electric rates runs the risk of creating rates that are less equitable. (Test 5).

Rate design modifications to promote cost-effective energy efficiency should only be made on a case by case basis, and only after addressing the following important considerations.

- **The effect on the incentive of customers who consume only in the block with the lower rate(s). (Tests 2,3) .** While changes in utility block electric rate design can take many forms, for illustrative purposes we will use the example of PSE's current residential rate, in which there are two blocks, and the rate for the tail block is higher than the rate in the first block. While those who consume in the tail block might, arguably, have a greater incentive to use less electricity because their rate is higher, the same argument must also conclude that those who consume only in the first block have a greater incentive to use more electricity. For PSE, up to one quarter of its customers do not consume any energy in the tail block during a billing period. This becomes even more of an issue in non-residential rate schedules, where there is much more variation in usage.
- **The fairness of any rate block proposed. (Test 5)**. In essence, blocking treats customers within a rate schedule differently. To be fair, this discrimination should have a cost basis, such as a showing that the unit cost of energy delivered to an individual customer in any given month increases the more energy that customer uses during that month. This is very difficult, if not impossible, to show.
- **The effect on the utility's incentive to deliver cost-effective energy efficiency. (Test 1)**. A prime issue in any consideration of changing rate structure, and the issue first mentioned in the EISA amendments to PURPA Section 111(d), is the potential lack of alignment brought about by the duality of effect. Simply put, lower bills for customers also mean lower revenues for a utility. While an increase in the tail block rate (over what it would have been otherwise) means a customer saves more for a given reduction in monthly load, it also means the utility receives less revenue for the same load reduction. This is true regardless of any savings to the utility related to the lower usage. It would always be better for the utility to achieved the same load (and cost) reduction without the extra lost revenue.
- **The effect on bill stability.** Increasing the tail block rate will make monthly bills more sensitive to weather, making customers pay more during hot or cold spells than they would otherwise. This is more likely to occur at the same time customers are already paying seasonally high monthly energy bills. In addition to increasing bill volatility, to the extent these increased bills are not associated with increased costs, this is unfair. (Test 5).
- **The effect on revenue stability.** Similarly, increasing the tail block will make monthly revenues to the utility more sensitive to weather or economic volatility, thus increasing the utility's risks. (Test 1). Many would argue that this increased risk should be accompanied by an increased allowed return on equity, thus increasing the cost of capital to all customers. (Test 4). Again, it would be better for the utility to achieve the same load (and cost) reduction without this destabilization of revenues and increased cost.

- **The nature and magnitude of the effect of price on energy efficiency. (Tests 2, 3)**. The nature and magnitude of price elasticity are subject to debate. If one is to rely on modifications to current utility block electric rate design to promote energy efficiency, price elasticity suddenly leaps to the forefront as a major factor for consideration. The issues mentioned previously all weigh on the negative side of the debate over rate blocking. If these negatives are to be offset, one must have confidence in the estimate of price elasticity. Prior to relying on rate blocking, the debate over price elasticity must be settled, or at a minimum clearly described and defended.
- **Is it more effective to use other methods? (Test 4)**. Clearly, rate blocking can have negative impacts on the utility and certain customers, with questionable positive results. To the extent other methods can achieve the same results with less negative impact, such as targeted utility sponsored energy efficiency programs, they should be explored before this method is used.

In summary, we believe that changing the current blocking structure of utilities to achieve energy efficiency goals has many practical drawbacks, the most significant being that it does not align utility incentives with the delivery of cost-effective energy efficiency. While there is a potential benefit through the customer's response to higher prices, this benefit is more theoretical and uncertain. As a result, we believe the Commission should look elsewhere for better methods to promote cost-effective energy efficiency, such as the targeted programs and financial incentive mechanisms being conducted by utilities in the state.

In answer to the second sentence in the question posed by the Commission, any modifications regarding current utility block rate designs should only be made in a general rate case filing, where all of the above issues can be fully discussed in the context of the unique situation facing the filing utility and the evidence is available to actually set rates.

Question B.2. *What are the implications for utility conservation efforts if the incremental cost of power is higher than the cost of power embedded in rates? Under such circumstances, what, if any, incentives should be considered to encourage a utility to promote conservation between rate cases?*

Comments:

For this answer, we are assuming that the incremental cost of power is related to the cost of acquiring the next resource rather than the day-to-day cost of producing power from existing resources. The implication for utility conservation efforts of incremental costs higher than costs embedded in rates is the same as if incremental costs are the same as, or lower than, costs embedded in rates. Conservation should be implemented up to its cost effective limit.

Also, as noted in our previous comments, the combination of IRP rules and RCW 19.285 already provide sufficient policy guidance to appropriately establish the priority of energy efficiency resource acquisition.

Question B.3. *If customers supply much of the investment in energy efficiency, even when they participate in and receive utility sponsored incentives, what additional incentive could be provided by the electric rate design?*

Comments:

As discussed above, we feel the use of electric rate design is an inferior method of addressing the goal of acquiring energy efficiency resources. This is true regardless of whether or not customers supply much of the investment in energy efficiency. Thus the use of additional incentives to be provided by electric rate design would not be appropriate.

Question B.4. *Would an electric rate design with larger fixed charges reduce the customer incentive to conserve?*

Comments:

This question cannot be answered without first knowing the cost basis for the change in rates. While the increase in fixed charges might reduce the customer incentive to reduce consumption, this reduction might, or might not, lead to a decrease in the cost-effective energy efficiency. This would depend on the underlying costs.

If the question is whether an electric rate design with larger fixed charges aligns utility incentives with the delivery of cost-effective energy efficiency, and promotes energy efficiency investments, we strongly believe it does. An electric rate design with larger fixed charges, *up to but not exceeding full recovery of fixed costs*, helps align utility incentives with the delivery of cost-effective energy efficiency (Test 1) and it helps provide equitable rates for electric consumers. (Test 5). It is also a simple and efficient method of achieving these goals. (Test 4).

Principles of rate design require rates to be set at their cost of service. If fixed charges are set to recover less than the associated fixed costs of service, a portion of fixed costs must be recovered through volumetric rates. When fixed costs are recovered through volumetric rates, the fixed costs actually recovered from a customer will be larger or smaller than the true fixed cost, depending on the amount of energy that a customer consumes in a month. This will be true even though the customer's fixed costs are not larger or smaller in that month. If, instead, fixed charges are set to levels that recover the fixed cost of service (and no more), we would see the following:

- Customers would no longer pay more or less fixed costs than their neighbors. (Test 5).
- Customers would no longer pay more fixed costs in the winter (or summer), and during cold (or hot) spells. (Test 5).
- The amount of fixed costs actually paid by each customer would be stable and predictable. (Test 5).
- The utility's throughput incentive would be reduced (other things equal). (Test 1).

While the throughput incentive associated with below cost fixed charges can be addressed in other more complex ways, such as the use of decoupling mechanisms, removing the

recovery of fixed costs from volumetric rates is a much simpler, more easily understood, and more straightforward tool.

Given the above benefits, we believe the Commission should include in any rule or conclusion that might come from this inquiry a statement similar to the following:

"Electric rate design with larger fixed charges, up to but not exceeding full recovery of fixed costs, helps align utility incentives with the delivery of cost-effective energy efficiency, makes rates more equitable for consumers, and is encouraged."

In addition, we believe the following more general statement would provide clear guidance to utilities that the Commission fully supports the intent of the PURPA amendments in EISA Section 532(a)(17):

"One of the goals of retail rate design is the promotion of energy efficiency. In order to achieve this important goal, utilities will establish rates that align utility incentives with the delivery of cost-effective energy efficiency."

Suggested Rule Language:
WAC 480-100-xxx.
Electric rate design with larger fixed charges, up to but not exceeding full recovery of fixed costs, helps align utility incentives with the delivery of cost-effective energy efficiency, makes rates more equitable for consumers, and is encouraged.

WAC 480-100-xxx.
One of the goals of retail rate design is the promotion of energy efficiency. In order to achieve this important goal, utilities will establish rates that align utility incentives with the delivery of cost-effective energy efficiency.

Question B.5. *To what extent will the penalties under Initiative 937 provide an incentive for utilities to achieve the energy efficiency goals established in Initiative 937?*

Comments:

Prior to the Commission's adoption of the electric conservation incentive program in Docket No. UE-060266, PSE was subject to a penalty-only mechanism. This mechanism assessed a penalty if PSE did not achieve its electric savings targets, but there was no reward for meeting or exceeding those goals. Additional regulatory disincentives to pursuing energy efficiency beyond the penalty threshold include lost revenues from reduced energy sales, and lost earnings on the capital investment in electric generation and distribution investment avoided by acquiring energy efficiency resources. Thus, the Company had no incentive to more aggressively acquire electric energy efficiency resources beyond just avoiding a penalty.

PSE believes that a mechanism which provides both incentives and penalties, such as that approved by the Commission for PSE's electric energy conservation, encourages the

continued outstanding performance of energy efficiency programs over the long term. It is the Company's belief that a regulatory mechanism that emphasizes meaningful incentives to achieve desirable outcomes is more effective than a mechanism that focuses on penalties for not doing enough. A performance-based incentive mechanism for electric and gas energy efficiency would provide positive reinforcement for utilities to continue to aggressively acquire low cost, clean alternatives to traditional fossil fuel generation. It would also encourage innovation to develop and deliver new energy efficiency resources as they emerge.

C. State Consideration of the Smart Grid
Part A

Question C.A.1. *What constitutes a "qualified smart grid system?"*

Comments:

The Smart Grid is defined as the application of digital technology to the infrastructure and communications networks of all three major components of the utility model: generation, transmission and distribution. The Smart Grid will enable more information, optimization, and control for both the utility and empowered consumers of energy. The Smart Grid encompasses both more traditional electric components, such as switching equipment on the electrical distribution system, and the additional measurement, automation, and control that are applied to these traditional components. Thus, the Smart Grid system includes both electric components and information technologies. The application of Smart Grid systems and components is intended to bring about improved reliability and power quality, advanced asset management, optimization of energy supply and demand, and targeted customer services. Applying this definition to the utility and the consumer results in the following systems and components currently considered as qualified smart grid systems (this list is not all-inclusive):

- Substation Automation
- Distribution Automation
- Feeder Automation
- Home Energy Displays
- Direct Load Control
- Dynamic Pricing
- Renewables Integration
- Distributed Generation Integration
- Advanced Metering Infrastructure (AMI)
- Plug-in Hybrid Electric Vehicles (PHEV)
- Energy Storage
- Billing and Customer Information Systems
- Emergency and Outage Management Systems
- Generation and Energy Management Systems

Smart Grid equipment and functionalities may be applied to both utility operations, from the electric meter up to the distribution system, transmission system, and generation, and to customer activities, such as the use of direct load control on hot water heaters. For some applications, such as load control, the utilities and customers will work together to apply these technologies. Some of the aforementioned systems and components would be considered conservation or conservation-enabling technologies even without the designation of being "smart grid" systems or components.

Question C.A.2. *Are the technologies that constitute a "qualified smart grid system" commercially available? If so, how might adoption of today's smart grid technology affect adoption of future technology refinements?*

Comments:

Most of the technologies that constitute a "qualified smart grid system" are commercially available in a stand alone form, though few installations exist where all of the technologies have been operated in conjunction, though most should be used in coordination with the other components to be considered a system. Technology continues to evolve and as utilities apply more advanced technologies and communications to their systems to achieve a qualified smart grid system the evolution will be more frequent, for example, consider the life span of software and home computers. This is in contrast to the technology evolution that utilities have experienced for the past 50 years, that is, the slow (or lack of) evolution change in mechanical and manual equipment that utilities currently install. The establishment of standards or "open" standards to ensure equipment interoperability will assist utilities in minimizing and mitigating the risk of investing in today's technologies and will further enable industry application and development.

Question C.A.3. *The IRP rule currently requires the lowest reasonable cost set of resources to be determined after a "detailed and consistent analysis of a wide range of commercially available sources." Does this requirement already encompass "qualified smart grid systems?"*

Comments:

No, not adequately. Some aspects of smart grid are generation resource related. Such aspects could be incorporated into IRP analysis. System operation and customer service related aspects, along with backbone or enabling technologies, however, would not fit into an IRP. A more comprehensive view would be to consider a Smart Grid plan as the overall project. IRP analysis would be used to estimate the value of potential generation resource-related elements of smart grid. Other aspects would be evaluated in different ways. Then a comprehensive assessment of all the quantitative and qualitative benefits and costs of a particular portfolio of smart grid applications could be evaluated.

Question C.A.4. *What level of screening and analysis of smart grid investment would constitute a demonstration to the Commission?*

Comments:

In the context of demonstrating to the State that the electric utility appropriately considered an investment in a qualified smart grid system in accordance with EISA Section 1307 subpart 18 A (shown below) inclusion of the six factors (total costs; cost-effectiveness; improved reliability; security; system performance; and societal benefit) as part of the utility's overall planning process should indicate appropriate demonstration that the utility adequately considered a qualified smart grid investment.

> (18) CONSIDERATION OF SMART GRID INVESTMENTS.—
> (A) IN GENERAL.—Each State shall consider requiring that, prior to undertaking investments in nonadvanced grid technologies, an electric utility of the State demonstrate to the State that the electric utility considered an investment in a qualified smart grid system based on appropriate factors, including—
> (i) total costs;
> (ii) cost-effectiveness;
> (iii) improved reliability;
> (iv) security;
> (v) system performance; and
> (vi) societal benefit.

Question C.A.5. *Are the six factors listed an adequate set for reviewing smart grid investments? Should additional factors be included? If so, what additional factors? What, if any, rules should govern measurement and evaluation of these listed or additional factors?*

Comments:

Consideration of a Smart Grid investment by a utility should indeed include the six factors listed (total costs, cost-effectiveness, improved reliability, security, system performance and societal benefit), but should also include assessment of cost recovery methods, emerging interoperability standards and long-term flexibility for future growth and technological advancement. It should also be recognized that installation of a qualified smart grid system is a long term plan and that as individual components are put into place to make up the system it will take time before the benefits as measured by the six factors will be realized by the utility and the consumer.

Part B

Federal Policy. *"Each State shall consider authorizing each electric utility of the State to recover from ratepayers any capital, operating expenditure, or other costs of the electric utility relating to the deployment of a qualified smart grid system, including a reasonable rate of return on the capital expenditures of the electric utility for the deployment of the qualified smart grid system."*

Comments:

This federal policy specifically allows states to consider both the authorization of rate recovery for qualified smart grid system investments as a separate process, as well as a

separate reasonable rate of return for capital expenditures on the future deployment of smart grid systems. It is noteworthy that the federal policy specifically uses the terms "relating to the deployment of a ..." and "for the deployment of the ..." We believe that this additionally indicates that this federal policy allows an electric utility to be authorized to recover operating expenditures and all other costs of the qualified smart grid prior to its deployment. It also indicates that the authorized reasonable rate of return on the capital expenditures for the future deployment should be decided prior to the deployment of the qualified smart grid. For the case of a future qualified smart gird deployment, a reasonable rate of return may be larger than the current authorized rate of return for all other capital investments.

To carry out what is allowed by federal policy, we propose the following procedures be allowed by the WUTC, and adopted into its rules:

Prior to finally committing to acquire or develop a qualified smart grid system, or any part thereof, an electric utility may file a petition with the commission requesting that the commission determine whether the decision to acquire or develop the qualified smart grid system or smart grid component is prudent.

In addition, or in the alternative, an electric utility may file a petition with the commission requesting that the commission determine whether the decision to continue forward with the acquisition or development of a qualified smart grid system or qualified smart grid component is prudent.

The commission will initiate an adjudicative proceeding in response to such a petition within thirty days after the petition is filed.

Suggested Rule Language:
WAC 480-107-xxx.
(1) Prior to finally committing to acquire or develop a qualified smart grid system, or any part thereof, an electric utility may file a petition with the commission requesting that the commission determine whether the decision to acquire or develop the qualified smart grid system or smart grid component is prudent.
(2) In addition, or in the alternative, an electric utility may file a petition with the commission requesting that the commission determine whether the decision to continue forward with the acquisition or development of a qualified smart grid system or qualified smart grid component is prudent.
(3) The commission will initiate an adjudicative proceeding in response to such a petition within thirty days after the petition is filed.

Part C

Question C.C.1. *What constitutes a "qualified smart grid system?"*

Comments:

The Smart Grid is defined as the application of digital technology to the infrastructure and communications networks of all three major components of the utility model: generation, transmission and distribution. The Smart Grid will enable more information, optimization, and control for both the utility and empowered consumers of energy. The Smart Grid encompasses both more traditional electric components, such as switching equipment on the electrical distribution system, and the additional measurement, automation, and control that are applied to these traditional components. Thus, the Smart Grid system includes both electric components and information technologies. The application of Smart Grid systems and components is intended to bring about improved reliability and power quality, advanced asset management, optimization of energy supply and demand, and targeted customer services. Applying this definition to the utility and the consumer results in the following systems and components currently considered as qualified smart grid systems (this list is not all-inclusive):

- Substation Automation
- Distribution Automation
- Feeder Automation
- Home Energy Displays
- Direct Load Control
- Dynamic Pricing
- Renewables Integration
- Distributed Generation Integration
- Advanced Metering Infrastructure (AMI)
- Plug-in Hybrid Electric Vehicles (PHEV)
- Energy Storage
- Billing and Customer Information Systems
- Emergency and Outage Management Systems
- Generation and Energy Management Systems

Smart Grid equipment and functionalities may be applied to both utility operations, from the electric meter up to the distribution system, transmission system, and generation, and to customer activities, such as the use of direct load control on hot water heaters. For some applications, such as load control, the utilities and customers will work together to apply these technologies. Some of the aforementioned systems and components would be considered conservation or conservation-enabling technologies even without the designation of being "smart grid" systems or components.

Question C.C.2. *Is there a distinction between replacing existing equipment with a "system" versus the replacement of some existing equipment with individual components?*

Comments:

Although many Smart Grid components could function as stand-alone systems, investment in replacing existing equipment with a "system" versus individual components should not be viewed differently, especially since implementing an entire "system" (which currently no singular vendor offers) will start by replacing existing equipment with individual

components. Many Smart Grid components tied to the electric grid (like automated switches) will in fact be individual implementations.

Question C.C.3. *Are the technologies that constitute a "qualified smart grid system" commercially available? If so, how might adoption of today's smart grid technology affect adoption of future technology refinements?*

Comments:

Most of the technologies that constitute a "qualified smart grid system" are commercially available in a stand alone form, though few installations exist where all of the technologies have been operated in conjunction, though most should be used in coordination with the other components to be considered a system. Technology continues to evolve and as utilities apply more advanced technologies and communications to their systems to achieve a qualified smart grid system the evolution will be more frequent, for example, consider the life span of software and home computers. This is in contrast to the technology evolution that utilities have experienced for the past 50 years, that is, the slow (or lack of) evolution change in mechanical and manual equipment that utilities currently install. The establishment of standards or "open" standards to ensure equipment interoperability will assist utilities in minimizing and mitigating the risk of investing in today's technologies and will further enable industry application and development.

Question C.C.4. What constitutes "obsolete equipment"?

Comments:

Obsolete equipment is commonly identified as equipment that is no longer useful and/or is outdated due to new technologies or designs. It is not necessarily related to its physical usefulness or ability to perform its originally intended function but more closely tied to being superseded by more advanced technologies.

Question C.C.5. *Should a cost effectiveness test be applied to the equipment replacement before recovery of book-value costs are allowed?*

Comments:

We believe that common practice should not be changed as a result of this standard. Obsolete equipment would be retired and closed to its depreciation reserve. If the net balance of the reserve is a debit and there is no "like" equipment to offset the reserve with in a depreciation study then the balance should be set aside for treatment as a regulatory asset and recovery requested in an accounting petition or rate proceeding. The IRP rule, in conjunction with the Commission's prudence standards, are sufficient policies with regard to mitigating the need for requiring a cost effectiveness test on obsolete equipment before recovery of book-value costs.

Question C.C.6. *How would net salvage value be accounted for under this standard?*

Comments:

The same as it always is which is to be included in rates based on Commission approved depreciation studies. For equipment that is retired due to obsolescence, it would be retired as discussed above, and future deprecation studies would adjust depreciation rates based on activity within that FERC related to salvage value and costs of retirement.

Question C.C.7. *How would this standard conform to used and useful standards?*

Comments:

A 'used and useful' review examines whether an investment will be providing service, or will be capable of providing service, to the utility's customers in the foreseeable future. Such investments can be phased into rates over time as the investment becomes needed in order to provide safe and reliable service to the utility's customers. The IRP rule, in conjunction with the Commission's prudence standards discussed in Part B above, are sufficient policies with regard to achieving the used and useful standard. If any asset has already been allowed recovery in rates, the asset has already passed the used and useful standard as determined by the Commission. Therefore recovery should be allowed for these assets as they were determined to be prudently incurred at the time of investment. Utilities should be allowed full recovery of assets deemed by the Commission to have been prudently incurred.

D. Smart Grid Information

WUTC Comments. *"… there are no time-based electricity prices in the wholesale electricity market available to retail electricity customers of utilities regulated by the Commission. Indeed, no centralized market with a single hourly or daily clearing price for wholesale power exists in the Pacific Northwest."*

Comments:

There are centralized wholesale electricity markets with daily and hourly prices in the Pacific Northwest, most notably Mid-C, California-Oregon Border (COB) and Nevada-Oregon Border (NOB). Those centralized wholesale electricity markets have several time-based indexes associated with them. The Mid-C has both hourly prices (Powerdex) and daily prices (Dow Jones) available.

II. PURPA Standards for Natural Gas Utilities
A. Energy Efficiency

Question A.1. *Should the Commission, by rule, adopt Standard 5(B) establishing cost-effective energy efficiency as a priority resource?*

Comments:

No. The IRP rule, in conjunction with the Commission's prudence standards, are sufficient policies with regard to encouraging utilities to acquire all cost effective energy efficiency.

Question A.2. *What is a "priority resource"?*

Comments:

With regard to energy efficiency, PSE interprets the term "priority resource" to mean energy efficiency programs that are part of the optimal mix of resources, balancing costs and risks. Thus, "priority resource" incorporates the concept of cost effectiveness.

Question A.3. *Does the term "priority resource" differ in affect from the requirement to pursue all cost-effective conservation? If so, how?*

Comments:

No.

Question A.4. *If establishing energy efficiency as a priority resource requires the acquisition of energy efficiency in aggregate that is above the cost-effectiveness threshold, would its establishment as a priority resource conflict with any state law?*

Comments:

Such a requirement may not be in conflict with the IRP rules. The IRP rules define "lowest reasonable cost" to reflect public policies passed by Washington State, which would probably include WAC rules. Such a change, however, would require rules to make clear what level of energy efficiency is appropriate.

Question A.5. *If establishing energy efficient as a priority resource does not mean pursuing additional energy efficiency above the cost effectiveness threshold, then how would it differ from current Commission regulation and policy?*

Comments:

Possible incentives in RCW 19.285 for electric conservation provide an appearance of prioritization. Commission policies or rules specifically stating the commission will consider reasonable gas demand-side resource incentives would help make the strong showing that energy efficiency is a priority resource.

B. Rate Design Modifications to Promote Energy Efficiency Investments

In our comments, we will use the test identified in Section 532(b)(A) of the Energy Independence and Security Act of 2007, whether (1) rates allowed to be charged by a natural gas utility shall align utility incentives with the deployment of cost-effective efficiency. In

addition, the comments will address the Commission's considerations of whether the rate design modifications encourages (2) conservation of energy supplied by gas utilities, (3) optimal efficiency of gas utility facilities and resources, and (4) equitable rates for consumers of natural gas. Our comments will refer to the above as Test 1 through Test 4.

Question B.1. *Are there any benefits from separating fixed-cost revenue recovery from the volume of transportation or sales service provided to customers that the Commission has not yet considered in either a rulemaking or in adjudication?*

Comments:

There is great value in separating fixed cost revenue recovery from the volume of transportation or sales service provided to customers. It removes the throughput incentive, which is a regulatory and management disincentive to energy efficiency. It creates rates that are more fair, because customers who use more, or less, gas than their neighbor are not forced to pay more, or less, fixed costs than their neighbors. It creates bills that are more stable. It creates revenues to the utility that have less variability. It means bills, and revenues, will not increase as much during cold snaps. Please also see our response to a similar question regarding electricity for more discussion.

We believe the Commission has heard many of these arguments in previous rulemakings or adjudications. What is new is the emphasis through federal law on the alignment of utility incentives with the delivery of cost-effective energy efficiency (Test 1). Given this new emphasis, we believe the Commission should make a general statement in support of separating fixed-cost revenue recovery from the volume of gas transportation or sales service similar to the following:

"The separation of fixed-cost revenue recovery from the volume of gas transportation or sales service helps align utility incentives with the delivery of cost-effective energy efficiency, makes rates more equitable for consumers, and is encouraged."

Question B.2. *Are there any drawbacks of separating fixed-cost revenue recovery from the volume of sales service provided to customers that the Commission has not yet considered?*

Comments:

To the extent fixed costs are recovered from volumetric rates, utilities have an opportunity to improve profitability between rate cases by promoting gas sales. The separation of fixed cost revenue recovery from volume of sales service removes that opportunity. Some might consider this a drawback – we would consider this the removal of a disincentive.

Question B.3. *What advantages are there in establishing by rule (rather than through case-by-case adjudications) an incentive for the utility to successfully manage energy efficiency that allows the utility to keep some portion of the "cost-reducing benefits" accruing from the programs?*

Comments:

The definition of "cost-reducing benefits" of programs should be consistent with the Total Resource Cost (TRC) test of cost effectiveness already required by the Commission for utility energy efficiency programs. The TRC test nets the benefit of the costs avoided through program energy savings (including associated environmental benefits) against the total costs incurred by both the utility and participating customers to achieve those energy savings. A reasonable incentive mechanism will share the total net savings between utility shareholders and ratepayers in such a way that shareholders receive a significant incentive to aggressively pursue energy efficiency, while still retaining most of the total net benefits for ratepayers.

Question B.4. *If the conservation measures near the total-resource-cost (TRC) threshold are the hardest to achieve and would provide the least amount of shared "cost-reducing benefits" to the utility, would the utility be less inclined to achieve conservation that was near the cost-effective threshold?*

Comments:

If significant lower cost energy efficiency opportunities are available, it certainly would be to the benefit of utilities and their customers to maximize acquisition of those savings. However, as this "low-hanging fruit" is acquired, there is still benefit to pursuing higher cost resources, as long as the costs of energy efficiency remain less than the avoided cost. An incentive mechanism that rewards utilities for the total amount of cost-effective conservation achieved can provide motivation to acquire both the lowest hanging fruit as well as reaching higher up the tree.

Question B.5. *If the utility received some portions of the cost savings from energy efficiency, should that portion of cost be added to the TRC?*

Comments:

PSE is committed to ensuring that its portfolio of natural gas energy efficiency programs is, in aggregate, still cost effective after including any incentive payment earned in a program year.

Question B.6. *Would such "cost-reducing benefits" to be shared be calculated on a measure-by-measure basis? If not, would such a sharing mechanism encourage the utility not to pursue a mix of measures that are, in sum, at the cost effective threshold?*

Comments:

The net benefits which could be shared through an incentive mechanism should be based on the aggregate total across a utility's entire energy efficiency program portfolio. This packaged approach allows very cost-effective measures to offset the impact of less cost-effective measures. A measure-by-measure basis for determining the incentive would actually create a disincentive for utilities to pursue higher cost measures. A measure-by-measure approach would establish different classes of measures based on their individual

cost effectiveness and each class might receive different treatment, with less value given to more costly (but still cost-effective) measures, discouraging utilities from pursuing them.

Question B.7. *Could a practical rule be fashioned that states promoting energy efficiency is one of the goals of natural gas rate design while at the same time allowing actual rate designs to vary with each company's cost structure and needs?*

Comments:

Yes. We believe a practical rule which incorporates EISA Section 532(b)(A) would be helpful. Please see the following for our suggested language of the rule.

"One of the goals of retail rate design is the promotion of cost-effective energy efficiency. In order to achieve this important goal, utilities will establish rates that align utility incentives with the delivery of cost-effective energy efficiency."

In addition, please see our comments regarding electric rate design. We believe the issue of desirability of larger fixed charges is as applicable to gas rate design as electric, and the following practical rule should be established by the Commission.

"Gas rate design with larger fixed charges, up to but not exceeding full recovery of fixed costs, helps align utility incentives with the delivery of cost-effective energy efficiency, makes rates more equitable for consumers, and is encouraged."

Suggested Rule Language:

WAC 480-90-xxx.
One of the goals of retail rate design is the promotion of cost-effective energy efficiency. In order to achieve this important goal, utilities will establish rates that align utility incentives with the delivery of cost-effective energy efficiency.

WAC 480-90-xxx.
Gas rate design with larger fixed charges, up to but not exceeding full recovery of fixed costs, helps align utility incentives with the delivery of cost-effective energy efficiency, makes rates more equitable for consumers, and is encouraged.

PSE appreciates the opportunity to present its viewpoint on this issue and looks forward to further discussions on this topic. Please direct any questions regarding these comments to Eric Englert at (425) 456-2312 or the undersigned at (425) 462-3495.

Sincerely,

Eric E. Englert for
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Tom DeBoer
Director – Federal & State Regulatory Affairs