

**BEFORE THE WASHINGTON
UTILITIES AND TRANSPORTATION COMMISSION**

WASHINGTON UTILITIES AND)	
TRANSPORTATION COMMISSION,)	
)	
Complainant,)	
)	
v.)	Docket No. UE-050684
)	Docket No. UE-050412
PACIFICORP d/b/a PACIFIC POWER &)	<i>Consolidated</i>
LIGHT COMPANY)	
)	
Respondent.)	
.....)	

**POST-HEARING OPENING BRIEF OF THE
NATURAL RESOURCES DEFENSE COUNCIL**

Dated: February 27, 2006

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I. Summary of the Argument

The Washington Utilities and Transportation Commission (UTC) recently reaffirmed that a central goal of regulated utilities' resource planning is to "meet system demand with a least cost mix of generating resources and conservation." WAC 480-100-238 (1). Yet fundamental asymmetries persist between utilities' incentives to make investments in generating resources and conservation, in terms of the resulting impact on utilities' financial health (TR. 1096-97). In this proceeding, the Natural Resources Defense Council (NRDC) and PacifiCorp have advanced a Joint Proposal to address these asymmetries by eliminating a significant financial barrier to utilities' conservation investments (Exh. No.681-T).

The Joint Proposal seeks a three-year pilot test of the true-up mechanism proposed in NRDC's testimony (Exh. No. 671-T), which would minimize administrative costs, opportunities for gaming, and rate instability, while ensuring that fluctuations in retail sales do not affect PacifiCorp's ability to recover its authorized fixed-cost revenue requirement. Staff's response is entirely constructive (Exh. No. 701-T), and Staff is right to suggest that a key factor in evaluating any pilot program would be the Company's conservation performance. But the Commission should reject Staff's proposal to dilute the test significantly by removing generation and transmission costs, which account for more than half of the problem that the mechanism aims to solve. The Joint Proposal does not prejudice (or affect) the interjurisdictional issues on cost allocation that appear to account for Staff's principal concerns here; the true-up mechanism is to be "based on the Commission's findings regarding [the Company's] approved revenue requirement in this docket", not on any party's preferred cost allocation. Exh. No. 681-T (Joint Statement), p. 1, item 2.

Public Counsel's numerous objections rest in part on a misunderstanding of both the effect of the Joint Proposal on weather risk and the magnitude of the Company's current conservation efforts; the proposal does not shift weather risk to the Company's customers, and the Company is not in fact now close to achieving the conservation performance benchmark proposed in the NRDC testimony.

Public Counsel's principal contention is that the Joint Proposal is unnecessary because PacifiCorp can count on recouping all losses from reduced retail consumption by reselling into wholesale markets. Exh. No. 691-T, pp. 22-31. This is implausible on its face; few if any businesses could survive by betting that a commodity's wholesale price would remain at or above its retail price for an extended period. And Public Counsel is unconvincing and at best premature in its additional claim that the Joint Proposal would justify or compel a change in the Company's capital structure. *Id.*, pp. 17-21. Nothing of the sort is implied by a pilot program of limited duration, with stringent caps on rate impact and elimination of the Company's longstanding opportunities to profit from increased retail sales.

II. The Joint Proposal of NRDC and PacifiCorp is a Prudent Way to Test a Promising Strategy for Removing Barriers to Cost-Effective 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." Exh. No. 671-T (Cavanagh), p. 2. Indeed, more than 90% of PacifiCorp's fixed costs are recovered through variable rather than fixed charges (TR. 1082: 3-5), so that "every reduction in sales from efficiency improvements yields a corresponding reduction in cost recovery, to the detriment of shareholders." Exh. No. 671-T (Cavanagh), p. 3.

The aim of the Joint Proposal filed by NRDC and PacifiCorp (Exh. No. 681-T) is to replace this dysfunctional incentive system with “a true-up mechanism that minimizes administrative costs, opportunities for gaming, and rate instability, while ensuring that fluctuations in retail sales do not affect PacifiCorp’s ability to recover its authorized fixed-cost revenue requirement.” Exh. No. 671-T, p. 15. The Joint Proposal builds on extensive regulatory precedent in Washington and other states (id., pp 9-14), and responds to a specific invitation issued by the Commission at the close of the Company’s last rate case (id., p. 10-11). Recognizing that some concerns persist despite extensive discussions among all parties, the Joint Proposal “gives the Commission a way to test the mechanism in operation over a limited period, with carefully constrained rate impacts and a through independent review of the mechanism’s operation.” Exh. No. 681-T, pp. 1-2.

Under the Joint Proposal, the Commission would establish authorized revenue requirements for PacifiCorp on a per-customer basis, in residential and non-residential categories (excluding industrial customers served under Schedule 48T). Exh. No. 671-T, p. 16. The Commission would direct the Company “to establish annual tracking of customer counts and revenue recovery based on retail sales, and to maintain a balancing account that reflects the differences between actual and authorized revenues.” Id. The company would be “authorized to file annually to secure any true-ups necessary to eliminate positive or negative balances, following notice to the public and opportunity for hearing.” Id. The tracked revenues would be weather adjusted, “so that no shift of weather-related financial risk to customers would occur as a result of the mechanism,” and “[t]he maximum annual rate impact of the true up mechanism for any customer class should be capped at 2%, with any residual account balances carried forward to the next true-up filing.” Id.

In addition to removing potent disincentives to conservation investments, this mechanism “is also designed to free up the company to be an aggressive proponent of energy efficiency . . . at state and federal levels.” TR. 1124: 16-19. “Efficiency policy at the state and federal level vitally depends upon an energized utility base (TR. 1125: 1-2),” and “right now PacifiCorp has absolutely no business reason . . . to be an effective advocate at the state and federal level for efficiency policy.” TR. 1124: 21-24.

III. Staff’s Proposed Amendment to the Joint Proposal Should Not be Adopted, but the Commission Should Consider Providing Guidance to All Parties Regarding its Expectations on Conservation Progress.

The Cross-Answer Testimony of Commission Staff takes no position on the reasonableness of a decoupling mechanism, questions whether the mechanism will in fact increase the pursuit of cost-effective energy efficiency, and recommends that any approved mechanism be limited to fixed costs of distribution, omitting transmission and generation. Exh. No. 701-T, pp. 2, 6, 12.

On the issue of linking the pilot test to improved energy efficiency performance, which two Commissioners also raised at the January 20 hearing, NRDC’s witness was unequivocal: “So I repeat, I have absolutely no problem with the Commission, if it approves a pilot test, making clear that a crucial criterion in evaluating the test will be the extent to which the company can improve on its current performance on energy efficiency.” TR. 1100: 12-16.

But the Commission should not accept the invitation to limit the true-ups to fixed costs of distribution. NRDC’s testimony indicates that more than half of PacifiCorp’s total fixed-cost annual revenue requirement (\$88 million of \$155 million, or 57%) is in the

categories that Staff wants to exclude. Exh. No. 672, p. 1 (Response to NRDC Data Request #1, “Fixed Costs”). The point of the Joint Proposal is to test a mechanism that is capable of removing a financial disincentive to conservation, not just 43% of that disincentive. And Staff’s rationale for the exclusion lies in concerns about interjurisdictional cost allocations (Exh. No. 701-T, pp. 14-15), which are simply not affected by the Joint Proposal. The Proposal will work with whatever resolution the Commission reaches on the interjurisdictional issues; it does not attempt either to impose or influence a resolution. Specifically, the fixed-cost revenues to which the mechanism is applied would reflect “the Commission’s findings regarding [the Company’s] approved revenue requirement in this docket.” Exh. No. 691-T (Joint Statement), p. 1, item 2.

IV. Public Counsel’s Objections to the Joint Proposal are Without Merit.

A. Wholesale Electricity Markets do not Reliably Compensate Utilities for Lost Retail Sales.

Public Counsel has many objections to the Joint Proposal, but the most vehement center on the observation that wholesale electricity rates were higher than retail rates when Public Counsel filed its testimony, and any lost revenues from reduced retail sales could have been recouped through wholesale transactions at that time. Exh. No. 691-T (Lazar), pp. 22-31.

But Public Counsel’s testimony concedes, wholly appropriately, that the wholesale market is “highly volatile” and that “I do not claim the expertise to forecast” its movements. Id., p. 31. NRDC’s testimony in support of the Joint Statement noted that “this is a new and complex issue that would be difficult to resolve in the absence of experience with an actual mechanism,” that “on a multi-state system operating in multiple markets, it is far from clear

how and to what extent retail sales on one part of the system would translate into partially or wholly offsetting revenues for the system as a whole,” and that “under some conditions wholesale market conditions could increase, rather than reduce, losses to PacifiCorp from reduced retail sales.” Exh. No. 681-T (Cavanagh), p. 2. And given the historic relationship between wholesale and retail prices in this and all other markets, “if the Commission believes that a true-up mechanism is the right long-term policy for PacifiCorp, it could conclude that over time competitive wholesale markets are likely on average to preclude any appreciable recovery of retail fixed costs from wholesale sales revenues.” Id.

Finally, it should be emphasized that the proposed pilot test lasts only three years (eliminating about half of the potential cascading impacts projected by Public Counsel if unprecedented elevations in wholesale prices somehow persisted over five years), and the proposed independent assessment “would include a review of the impact (if any) of the Company’s wholesale market activities on cost recovery, and would include recommendations on how (if at all) future true-up mechanisms should be adjusted to accommodate wholesale market conditions.” Exh. No. 681-T (Joint Statement), p. 1, item 3.

B. California’s Electricity Rates are Irrelevant to the Joint Proposal.

Public Counsel at one point characterized the NRDC proposal as “a California style decoupling mechanism” (TR. 1141: 6-7 (ffitch)), and made pointed references throughout cross-examination to the disparity between California’s and Washington’s retail electricity rates. But as NRDC’s witness responded, the Joint Proposal includes “very important differences” from the California precedents: it is “vastly simpler, with rate constraints and with weather risk staying with the Company.” (TR. 1076: 1-2). Asked whether he advocated

“punitively high electricity rates as a solution”, NRDC’s witness responded “Certainly not, any more than I advocate changes in rate structure that would reduce rewards for saving energy.” Exh. No. 671-T, p. 6. But Washington’s lower electricity rates do not eliminate the linkage between fixed cost recovery and retail sales, and NRDC and PacifiCorp have proposed a Washington solution tailored to Washington needs.

C. Public Counsel’s Contention Regarding Potential Capital Structure Changes Following Decoupling is at Best Premature.

Public Counsel advances a (characteristically) intriguing contention about the ultimate impact of the true-up mechanism: by reducing risks associated with fixed-cost recovery, it might allow for a rebalancing of the Company’s capital structure, with less equity, more debt, and lower annual costs to customers. Exh. No. 691-T, pp. 17-21. The short answer is that no such rebalancing is remotely plausible without actual experience with the mechanism in operation. Moreover, there is another side to this issue. As NRDC’s witness noted (TR. 1112-13):

[PacifiCorp is] giving away an upside in addition to being protected from the downside. The upside they’re giving away is that they can’t profit any more on increases in [retail] sales, and for most of the electric industry for most of the 20th century, that was a great wave to ride. And PacifiCorp is basically saying, we won’t ride it any more. The fact that relatively few companies are willing to do that helps explain why relatively few companies are joining environmental advocates to make proposals on decoupling in state commissions at the moment . . . So if you look at the actual risk, the company is protected against non-weather related sales fluctuations on the downside, [but] it’s giving up all of its opportunities to gain from sales increases.”

Bottom line: “it doesn’t look like a material change in risk to me.” TR. 1113: 18-19.

Of course, whatever the rationale, a Commission decision to reduce the Company's authorized return as the "price" of adopting a true-up mechanism would be the exact opposite of reducing barriers to utilities' energy efficiency investment.

D. Public Counsel's Objections Rest in Part on Misunderstandings Regarding Weather Risks, the "Complexity" of the Joint Proposal, and PacifiCorp's Current Level of Conservation Performance.

Public Counsel's summary of its objections to the Joint Proposal begins as follows: "Mr. Cavanagh's proposal would expose consumers to unjustified higher prices to pay for sales reduction due to weather . . ." Exh. No. 691-T (Lazar), p. 22. But in fact the proposal explicitly provides that "no shift of weather-related financial risk to customers would occur as a result of the mechanism," because "retail sales [would] be adjusted for weather-driven fluctuations before the true-ups are calculated." Exh. No. 671-T (Cavanagh), p. 16; see also TR. 1126-27 (Cavanagh).

Public Counsel later inexplicably references "the type of complex decoupling mechanism that Mr. Cavanagh has proposed." Exhibit No. 691-T (Lazar), p. 31. The "complex" mechanism, which takes about one double-spaced page to describe in full, consists of annual true-ups to reconcile actual and authorized revenue requirements, based on annual tracking of customer counts and revenue recovery, with a maximum annual rate impact of 2%. See Exh. No. 671-T (Cavanagh), pp. 15-16.

A final misconception involves Public Counsel's impression that PacifiCorp is already achieving electricity savings in Washington State that are comparable to the benchmark proposed by NRDC for a relatively aggressive conservation program. Exh. No. 691-T (Lazar), p. 21. In fact, the record shows that California utilities' savings targets,


measured as a fraction of systemwide electricity use, are “50% higher than the PacifiCorp demonstrated results in 2004,” and that those results amount to about *two-thirds of one percent* of electricity use on PacifiCorp’s Washington system. TR. 1095 (Cavanagh). Public Counsel almost certainly would agree with NRDC’s conclusion that “two thirds of 1% is not the best we can do.” Id.

V. Proposed Findings of Fact and Conclusions of Law

- A. Proposed Finding of Fact:** Lower retail sales associated with successful energy efficiency initiatives are likely to result in a reduced opportunity for the Company to recover its authorized fixed-cost revenue requirement, while increased retail sales will have the opposite effect. This introduces an inappropriate asymmetry between the consequences to shareholders of the Company’s investments in cost-effective conservation and those in generation alternatives.
- B. Proposed Conclusion of Law:** It is in the public interest to test a true-up mechanism designed to eliminate financial disincentives associated with the Company’s demand-side initiatives. The Commission approves the proposal in the Joint Statement in Support of True-Up Mechanism, Exh. No. 681-T, which provides for a pilot test of a true-up mechanism with a maximum annual rate impact of 2% (up or down), an independent impact assessment, and a report to the Commission at the conclusion of the three-year test period.

Dated: February 27, 2006

Respectfully submitted,

A handwritten signature in black ink that reads "Ralph Cavanagh". The signature is written in a cursive style with a large initial "R" and a distinct "C" for "Cavanagh".

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CERTIFICATE OF SERVICE

I hereby certify that I have this day served the **Post-Hearing Opening Brief of the Natural Resources Defense Council** upon all parties of record in this proceeding either via electronic mail or U.S. Air mail.

Dated at San Francisco, California this 27th day of February, 2006.



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