BEFORE THE WASHINGTON

UTILITIES & TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

Complainant,

v.

PUGET SOUND ENERGY

Respondent.

DOCKETS UE-240004 and UG-240005 (*Consolidated*)

CROSS-ANSWERING TESTIMONY OF DR. ROBERT L. EARLE
ON BEHALF OF THE
WASHINGTON STATE OFFICE OF THE ATTORNEY GENERAL
PUBLIC COUNSEL UNIT

EXHIBIT RLE-6T

September 18, 2024

CROSS-ANSWERING TESTIMONY OF DR. ROBERT L. EARLE

DOCKET(S) UE-240004 AND UG-240005

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I. INTRODUCTION & SUMMARY

Q. Please state your name and business address.

A. My name is Robert Earle. My business address is 1388 Haight Street, No. 49, San Francisco, California, 94117.

Q. By whom are you employed and in what capacity?

A. I am employed by Alea IE, LLC, as the owner.

Q. On whose behalf are you testifying?

A. I am testifying on behalf of the Public Counsel Unit of the Washington Attorney General's Office (Public Counsel).

Q. Are you the same Robert L. Earle who previously filed testimony in this proceeding?

A. Yes. On August 6, 2024, I filed Response Testimony on behalf of Public Counsel which was designated as Exhibit RLE-1CT.

Q. Please give an overview of your testimony.

A. My cross-answering testimony addresses two issues in the response testimony of UTC Staff (Staff). First, I address Staff witness Mr. Wilson's proposal to include Climate Commitment Act (CCA) allowance costs in forecast power costs and reviews of CCA allowance costs in the annual Power Cost Adjustment (PCA) proceedings. The Washington Utilities and Transportation Commission (Commission) should reject Mr. Wilson's proposals as unsupported by the facts. Second, I address Staff witness Mr. McGuire's proposed policy guidelines for trackers. While Mr. McGuire's discussion of policy guidelines for trackers is welcome as an initial attempt to formulate policy, the policy guidelines proposed should not be adopted by the Commission because they are too narrow.

II. CCA ALLOWANCE COSTS

Q. What is your recommendation regarding Staff witness Wilson's proposal to include CCA allowance costs in forecast power costs and provide for reviews in annual PCA filings?

A. I disagree with Staff and recommend the Commission reject witness Wilson's proposal in its entirety. I summarize my reasoning below.

- Staff's proposal is administratively complex, requiring the Commission, Puget Sound Energy (PSE or the Company), and the intervenors to guess at future costs in the compliance period and to do so in an expedited PCA proceeding.
- Staff's proposal requires forecasting the unforecastable. Staff witness Wilson's analysis conflates the difference between the role of an estimate and actual allowance costs incurred. Any review of allowance cost estimates that might be used for dispatch decisions can and should only be a review of the zone of reasonableness and cannot be a precise target, as Staff assumes.
- Including an estimate of allowance costs in power costs is unnecessary. There is no need to include the estimate for the purpose of dispatch and power purchases in net power cost forecast nor actual power costs because

the actual costs will be known 10 months after the compliance period is over.

- Compliance and prudency can only be determined at end of the compliance period. Allowances for a given year may be used in other years, and the Company must manage costs across the entire four years in a compliance period. The prudency of transactions in relation to CCA allowance costs depends on the compliance period as a whole.

Q. Please describe Staff's recommendation to review CCA-related activities in the annual PCA proceeding.

A. Staff's witness Mr. Wilson asserts that in his "opinion, the Commission will find it most efficient to review the prudence of PSE's CCA allowance use and transactions in annual power cost review proceedings."[1] His claim is based on "PSE's decision to buy, sell, hold or use allowances are intertwined with its unit dispatch and power purchase decisions. The CCA requires PSE to include the relevant carbon allowance price and emissions allowance obligation in all unit dispatch and power purchase decisions."[2]

Thus, key to his recommendation is his claim that the "CCA requires PSE to include the relevant carbon allowance price and emissions allowance obligation in all unit dispatch and power purchase decisions."

Q. Does this requirement matter?

A. No. While Public Counsel does not take a position on whether or in what manner the "CCA requires PSE to include the relevant carbon allowance price and

[1] Resp. Test. of John D. Wilson, Exh. JDW-1T at 27:3–5.
[2] *Id.* at 27:5–8.

emissions allowance obligation in all unit dispatch and power purchase decisions," how PSE incorporate allowance costs into unit dispatch and power purchase decisions is irrelevant to the allowance cost review process. The appropriate venue for review of CCA allowance costs is not in the annual power cost review proceedings. Moreover, it is not appropriate to include CCA allowance costs in power cost estimates as Mr. Wilson suggests.[3]

Q. Has Staff been consistent in its position on where and when CCA allowance costs should be reviewed for prudency?

A. No. In the PSE risk sharing mechanism (RSM) docket, Staff's witnesses, Messrs. McConnell and McGuire, recommend that CCA allowance costs be addressed in PSE's GRC and included in base rates.[4] Mr. Wilson by contrast recommends CCA allowance costs be included as power costs and addressed in annual power cost proceedings for both Avista and PSE.[5] While the discussion in Mr. Wilson's testimony for both Avista and PSE CCA concerns allowance costs for Avista's and PSE's electric utilities, and the CCA allowance costs for the PSE RSM docket concern those for PSE's gas utility, it is unclear why two different approaches are suggested by Staff.

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[3] *Id.* at 27:5–8.

[4] Resp. Test. of Kody McConnell, Exh. KM-1T at 10:5–10, *Wash. Utils. & Transp. Comm'n v. Puget Sound Energy*, Docket UG-230968 (filed July 18, 2024); Resp. Test. of Chris R. McGuire, Exh. CRM-1T at 3:6–15, *Wash. Utils. & Transp. Comm'n v. Puget Sound Energy*, Docket UG-230968 (filed July 18, 2024).

[5] Wilson, JDW-1T at 27:3–8; Resp. Test. of John D. Wilson, Exh. JDW-1CT at 4:17–19, *Wash. Utils. & Transp. Comm'n v. Avista Corp.*, Dockets UE-240006 and UG-240007 (*consolidated*) (filed July 3, 2024).

Q. How does Mr. Wilson justify his recommendation?

A. Mr. Wilson "suggests five factors that the Commission should weigh when determining how to review the prudence of CCA use and transactions."[6] His five factors are:

- Administrative simplicity;
- Necessity of reviewing the allowance price and other factors that should be considered in unit dispatch and power purchase decisions during the annual power cost proceeding;
- Consideration that decisions to transact (or not transact) in the carbon market and carbon auctions depends on the reasonableness of the carbon price estimate and carbon price forecast as it existed during the year;
- Consideration that it is preferable to account for the costs (or benefits) resulting from decisions to transact (or not transact) in the year in which those transactions affect power costs (using mark-to-market valuations for unused allowances, as discussed above); and
- Consideration that it will be easier to review the reasonableness of a utility's carbon price forecasting method after that method is exposed to a variety of real-world circumstances, which may take several years to manifest.

Q. How does Mr. Wilson apply his proposed factors to this case?

[6] Wilson, Exh. JDW-1T at 28:1–17.

A. Mr. Wilson claims that "the first three factors clearly weight in favor of reviewing all carbon allowance topics during the annual power cost proceeding."[7] The fourth factor according to Mr. Wilson is ambiguous because "PSE may buy or sell allowances in 2024 that are (or could have been) applied to its 2025 obligations, for example."[8] Finally, Mr. Wilson's says the fifth factor "weighs in favor of reviewing carbon allowance transactions at the end of the four-year compliance period."[9] It is thus important to note that, even according to his own analysis, Mr. Wilson's proposal fails two of his five factors.

Mr. Wilson opines that "the Commission will find it most efficient to review the prudence of PSE's CCA allowance use and transactions in annual power cost review proceedings."[10]

Q. Do you agree with Mr. Wilson's analysis?

A. No, I do not. Mr. Wilson conflates the method PSE uses to incorporate allowances costs into dispatch and purchasing with the actual costs of those allowances. These are two separate issues.

The first issue is whether and how PSE should incorporate allowance costs into unit dispatch and power purchase decisions. If PSE is required to incorporate allowance costs into unit dispatch and power purchase decisions, PSE may need to have an estimate of allowance costs. That estimate is for the purpose of dispatch and power purchases and will, of course, affect power costs. And, if the estimate used for the purpose of dispatch and power purchases is imprudent *with*

[7] *Id.* at 28:18–19.
[8] *Id.* at 28:19–21.
[9] *Id.* at 28:21–22.
[10] *Id.* at 29:1–3.

respect to dispatch and power purchases, then it should be subject to review. However, there is no need to include the estimate for the purpose of dispatch and power purchases in either net power cost forecasts, or actual power costs in the annual power cost proceeding. This is because the actual costs of allowances are not yet known and will not be known until 10 months after the compliance period is over. As Mr. Wilson admits "compliance requirements do not occur at the end of each calendar year but require partial and then final surrender of required allowances over a four-year compliance period."[11]

The second issue is the cost that PSE incurs for allowances during a compliance period. These costs and their prudence can only be judged for a compliance period *after* the compliance period is over and the 10-month true-up period is done. Because, with some limitations, allowances for a given year may be used in other years, a utility must manage costs across the years in a compliance period. As discussed in my testimony in the PSE RSM docket,[12] and in the tracker discussion below, unlike power costs, it is possible to evaluate actual allowance costs in comparison with market outcomes with no need for the Commission to waste time on arguments about forecasting these costs.

Q. Do Mr. Wilson's five factors support his proposal?

A. No. Mr. Wilson's proposal also fails the evaluation of the factors he proposes. For the first factor, administrative simplicity, what he proposes is administratively complex requiring the Commission to guess at what future costs in a compliance

[11] Wilson, Exh. JDW-1CT at 23:5–7, *Wash. Utils. & Transp. Comm'n v. Avista Corporation*, Dockets UE-240006 and UG-240007 (*consolidated*) (filed July 3, 2024).
[12] Cross-answering Test. of Robert L. Earle, Exh. RLE-1CT at 24:19–27:2, *Wash. Utils. & Transp. Comm'n v. Puget Sound Energy*, Docket UG-230968 (filed Sept. 12, 2024).

period might be. Mr. Wilson as much as admits this by additionally supporting a prudency review after the four-year compliance period.[13] The second factor, necessity of reviewing any allowance cost estimates used in dispatch or power purchases, also fails to support Mr. Wilson's proposal. As discussed above, Mr. Wilson here conflates the difference between any estimate that is used and actual allowance costs incurred. At most, the necessity for review of the estimate of allowance costs that might be used for dispatch decisions should be a review of the zone of reasonableness of the estimate, not a precision target that requires forecasting the unforecastable. Mr. Wilson's proposal also fails the third factor, looking at transactions in the carbon market for the year. The prudency of transactions depends on the compliance period as a whole and can be measured against the market for the compliance period.

Thus, Mr. Wilson's proposal fails his first three factors, and Mr. Wilson admits that his proposal does not pass the fourth and fifth factors. Therefore, his proposal to make allowance costs part of power costs and reviewed in the annual power cost proceeding should be rejected.

Q. Please summarize your conclusions regarding the Staff proposal to include allowance costs in power cost forecasts and annual power cost proceedings.

A. In sum, despite extensive discussion, Mr. Wilson does not square the circle on why establishing prudency on an annual basis is reasonable for ratepayers or the utility. PSE has both the four-year compliance period plus 10 months after it to comply with CCA allowance requirements. Therefore, the cost of compliance can

[13] Wilson, Exh. JDW-1T at 29:10–15.

only be determined after the compliance period and the 10-month balancing period is over. A prudency determination on an annual basis is like declaring a winner after only one quarter of a basketball game is over.

III. POLICY GUIDELINES FOR TRACKERS

Q. Please describe Staff's proposed policy guidelines for trackers.

A. Staff provides an extensive discussion of trackers and develops proposed policy criteria as to whether, in general, the Commission should adopt a tracker.[14] Staff summarizes its position as:[15]

> Staff's position with respect to the need to establish policy standards for authorizing trackers is based on the recognition that trackers shift risk onto ratepayers, disrupt the utility's incentive to control its costs (further exacerbating the risk that is shifted onto ratepayers), and add to the Commission's administrative burden. Because trackers have these negative effects, authorizing a tracker is, as a general matter, inconsistent with the public interest.

Q. Do you agree with Staff's position on trackers?

A. No. I do not agree with Staff's position on trackers. While Staff provides a useful discussion of trackers, Staff's discussion is drawn too narrowly to be generally applicable as illustrated in my discussion of PSE's CCA tracker below.

Q. Please explain why Staff's proposal is too narrow and would result in harm to ratepayers.

A. The problem with Staff's analysis starts with its discussion of "variance risk." Staff defines variance risk in this passage:[16]

> When rates are set, but before actual costs are incurred, there is uncertainty with respect to the degree to which actual costs will differ from the level of costs embedded in rates. This uncertainty (i.e., the

[14] Resp. Test. of Chris R. McGuire, Exh. CRM-1T at 26:4–52:10.
[15] *Id.* at 45:12–17.
[16] *Id.* at 30:1–4.

"risk" that actual costs will be different than forecasted costs) is called "variance risk."

Variance risk, as Staff defines it, does not capture all the risk that consumers face. Staff's definition leaves out some of the risk that consumers face if costs are embedded in rates. When costs that are difficult to forecast are embedded in rates, consumers face the risk that the forecast will err on the high side. This means that consumers will end up paying too much.

Q. How can forecasts contribute to consumers consistently overpaying?

A. For costs that are relatively straightforward to forecast such as operation and maintenance costs for power plants, there is little forecast risk and embedding such forecast costs in rates provides incentives for a utility to reduce its costs and gain from regulatory lag. Costs that are difficult to forecast, however, can result in a battle between the utility and interested parties over the forecast. The utility has the clear advantage in this contest given the informational asymmetry between the utility and interested parties.

Q. Please provide an example of how applying Staff's proposal would create unintended consequences and lead to higher costs.

A. As an example, each of the three reasons Staff gives for saying a tracker is inconsistent with the public interest are incorrect when applied to the case of CCA allowance costs with an appropriate RSM. Staff claims that compared with embedding costs into rates, trackers shift risk onto ratepayers, disrupt the utility's incentive to control its costs, and add to the Commission's administrative burden.

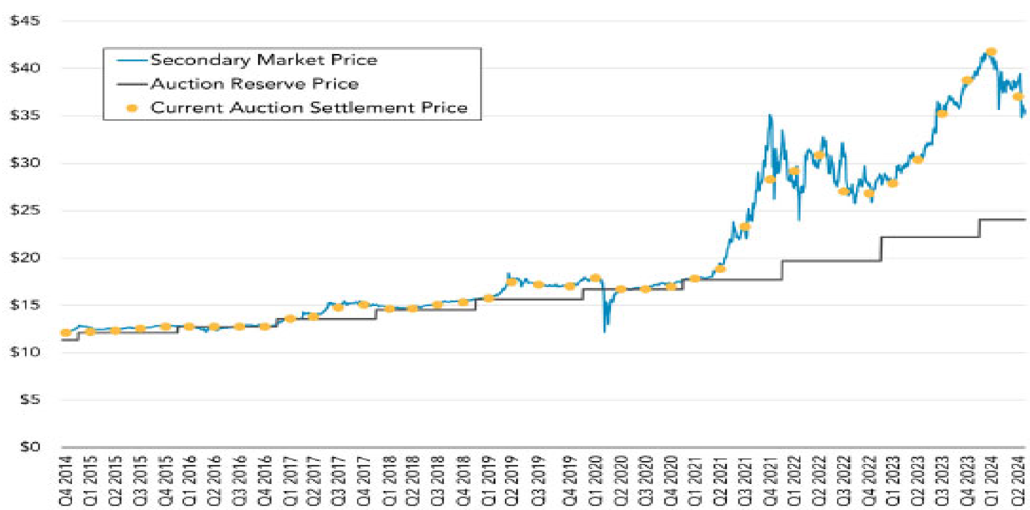
None of these claims are true in the case of CCA allowance costs with an appropriate RSM.

Q. Why does a tracker for CCA allowance costs shift less risk onto ratepayers compared to embedding costs in rates?

A. Because CCA allowance costs will be difficult to forecast. Staff's discussion incorrectly assumes that CCA allowance costs are easy to forecast. However, in contrast to costs such as operations and maintenance costs that are embedded in rates, there is not a long history of CCA allowance costs that can form the basis for the forecast of such costs.

In the California market, which Washington may potentially join, prices have been very volatile over the past three years, more than doubling during this period. Predicting the new levels of prices would have been difficult given the previous history.

Figure 1
Carbon Market Prices in California[17]



[17] California Air Resources Board, *Cap-and-Trade Program Data Dashboard: Carbon Allowance Prices.* https://ww2.arb.ca.gov/our-work/programs/cap-and-trade-program/program-data/cap-and-trade-program-data-dashboard (last visited Sept. 5, 2024).

Q. What evidence suggests Washington allowance costs may be difficult to forecast?

A. Washington allowance prices doubled in the space of the first six months of the market, then fell back towards the level of original prices.[18]

Along with the volatility of prices, a utility is faced with volatility in demand due to weather conditions or other factors. In other words, the forecasting problem is not just beset by price volatility, but also demand volatility. Allowance costs are the product of both price and demand, making them doubly difficult to forecast.

Staff's proposal to forecast CCA allowance costs in the general rate case (GRC) proceedings further complicates the forecasting problem. Because the opportunity to buy and sell allowances to cover a utility's obligations extend through the four-year compliance period plus ten months, allowance cost forecasts for a GRC period must consider the demand over the four-year compliance period, and prices over the whole four-year compliance period plus the additional 10-month true-up period. A GRC period that includes a 10-month true-up period must include forecasts for both the current compliance period as well as the next.

Q. Please provide an example of how Staff's proposal would apply to a case in front of the Commission.

A. If PSE's next GRC for the years 2027 and 2028, is filed in 2026, under Staff's proposal, PSE would have to sometime in late 2025 forecast prices and demand

[18] Cross-answering Test. of Robert L. Earle, Exh. RLE-1CT at 9:3–6, *Wash. Utils. & Transp. Comm'n v. Puget Sound Energy*, Docket UG-230968 (filed Sept. 12, 2024).

levels for 2026 through October 31, 2031. It would also have to use these forecasts to determine its strategy through October 31, 2031, to forecast its costs.

Q. What incentive would this structure provide the Company in this example?

A. The Company is incentivized under Staff's proposal to overestimate its costs. With so many unknowns at play and looking five to six years into the future at the time of the forecast, the Company could likely make a plausible case for its overestimate. In turn, Staff, Public Counsel, and other intervenors would need to examine the Company's forecasts and perhaps develop forecasts of their own. This process becomes very complex, expensive, and is likely to overestimate future costs. With so many unknowable factors, Staff's proposal therefore unnecessarily increases risk for both ratepayers and the Company.

Q. What would a CCA-tracker with an appropriate RSM achieve as compared to embedding those costs in rates?

A. A tracker with an appropriate RSM, on the other hand, reduces risk for both ratepayers and PSE. With an RSM the prices and quantities are known when collecting prudently incurred costs from ratepayers rather than having to forecast prices and quantities six years ahead of time. Moreover, PSE's strategy does not have to be forecast, but PSE can shift its strategy as it deems appropriate. Risk for both ratepayers and the utility is thereby lessened.

Q. Why does a tracker for CCA allowance costs give better incentives for a utility to control its costs compared to embedding costs in rates?

A. While it is true that if CCA allowance costs were embedded in rates, PSE would have the incentive to reduce its CCA allowance costs, embedding the CCA allowance costs in rates would only incentivize the Company to reduce its CCA costs for the time period covered by the GRC. Under Staff's proposal, a utility would be incentivized not only to overestimate its costs in a GRC period, but also to underspend and return the difference to shareholders. In the subsequent GRC period, the utility could reasonably ask for more than it would otherwise to compensate for its previous underspending. Staff's proposal will not only require forecasting prices and utility actions *ex ante*, but also it will require *ex post* review of utility actions. Staff's proposal distorts and disrupts PSE's incentives.

In contrast, using a tracker with a well-designed RSM would remove the utility's incentive to over-estimate its CCA allowance costs and to manipulate those estimates between GRC periods. A well-designed RSM would rely on actual market prices and ratepayer demand. PSE's performance would be judged against actual market outcomes, and it would be incentivized to lower CCA allowance costs as much as possible.

Q. Why does a tracker for CCA allowance costs lessen the regulatory burden compared to embedding costs in rates?

A. As discussed above, embedding allowance costs in rates necessitates the forecast of allowance prices and customer demand for gas many years into the future. Moreover, it necessitates specifying utility strategy in the face of those prices and demand. Under Staff's proposal, much time and effort would inevitably be spent arguing about the forecasting of prices, the forecasting of demand, and the forecasting of PSE's allowance cost strategy. Forecasting the utility's appropriate allowance cost strategy is unlike forecasting the utility's operation and maintenance practices. Operation and maintenance practices are usually well-defined by regular schedules, inspection of equipment, and historical practices. Forecasting the utility's strategy for allowances, on the other hand, involves numerous assumptions about a volatile market. Debates on utility forecasting waste the Commission's time and should be avoided.

In contrast, a tracker with an appropriate RSM would avoid the need for forecasting anything. The Commission would not have to sort through forecasts subject to high variance, nor pick a forecast as to what PSE's strategy should be ahead of time when changing market conditions could shift that strategy. Staff, Public Counsel, and other intervenors would not have to spend effort examining PSE's price, demand, and strategy forecasts. Finally, PSE for its part, would be relieved of the burden of producing all these variance suffering forecasts, which would subject them to discovery, submitting direct testimony, producing rebuttal testimony, participating in hearings, and preparing briefs.

Thousands of hours of time would likely be saved by using a tracker with an appropriate RSM for CCA allowance costs rather than embedding those costs in rates.

Q. Staff proposes three criteria for whether a tracker is in the public interest that the Commission should adopt. What are those criteria, and do you agree with them?

A. Staff proposes three criteria. These are:

1. "For a specified set of costs, does the utility cost control incentive interfere with progress toward meeting an important public policy objective?"[19]
2. "For a specified set of costs for which the Commission has authorized deferred accounting treatment, is allowing the deferral balance to continue to accumulate through the utility's next GRC likely to create severe intergenerational inequities?"[20]
3. "For a specified set of costs, is the variance risk so high that cost increases outside of the utility's ability to control are reasonably likely to have a substantial impact on the utility's earnings?"[21]

While each of these criteria has some merit, they miss the larger picture described in the discussion above about embedding CCA allowance costs in rates. Criterion one, for example, assumes trackers have no incentives for cost control. While it is true that some may not, what is at issue here is a tracker with an RSM, that is a utility incentive mechanism, not a tracker without an incentive mechanism. None of Staff's criteria consider the important issue of how reliably costs can be forecasted and the potentially significant impact those forecasted costs would have if they were embedded in rates.

Q. Should the Commission adopt Staff's criteria for evaluating whether authorizing a tracker serves a specific public interest purpose?

A. No, for two reasons. First, as demonstrated above, Staff's criteria are too narrow. In just the single example I provide, Staff's criteria fail to account for a CCA allowance tracker with an effective RSM. Second, Staff has proposed these

[19] McGuire, Exh. CRM-1T at 43:18–19.
[20] *Id.* at 44:3–6.
[21] *Id.* at 45:3–5.

criteria in the narrow context of this Docket and the current PSE RSM docket.[22] If the Commission were to adopt Staff's proposed criteria beyond PSE's particular issues, then intervenors not involved in these dockets, including Avista and PacifiCorp, would be disadvantaged by denying them the ability to respond to Staff's proposal.

Q. Is there an alternative process to establishing policy guidelines?

A. While Public Counsel is loath to suggest yet another docket on the Commission's agenda, if the Commission wants to establish policy guidelines for trackers, then the Commission should consider an opportunity for a full discussion across all interested parties.

Q. Does that conclude your testimony?

A. Yes, it does.

[22] Resp. Test. of Chris R. McGuire, Exh. CRM-1T at 3:6–15, *Wash. Utils. & Transp. Comm'n v. Puget Sound Energy*, Docket UG-230968 (filed July 18, 2024).