Agenda Date: November 7, 2001
(These items are from recessed open meeting of October 31, 2001.)

Item Nos.: 2A and 2H

Docket: UE-011442 & UE-010410
Company Name: Puget Sound Energy

Staff:
James M. Russell, Regulatory Consultant
Joelle Steward, Policy Research Specialist
Merton Lott, Energy Coordinator
Thomas Schooley, Regulatory Consultant
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Recommendations:

1) Allow the filing of Puget Sound Energy (PSE or Company) in Docket UE-011442 to become effective November 8, 2001, on less than statutory notice.

2) Deny (or in the alternative, set for hearing) PSE's Petition to Amend Order in Docket UE-010410 for the period prior to November 8, 2001.

3) Take no action, or set for hearing, PSE's Petition to Amend Order in Docket UE-010410 as it applies to the period November 8, 2001, through December 31, 2001.

Background:

Effective May 1, 2001, PSE began offering customers a bill credit of $0.05 per kilowatt-hour (kWh) for every kWh a customer saved beyond a 10% threshold. The Conservation Incentive Credit (CIC) program (Schedule 125) was filed and approved to run through December 31, 2001. This program was filed and approved in conjunction with PSE's Time-of-Day pilot program in Docket UE-010409. In the companion Docket UE-010410, an accounting petition, PSE was permitted by Commission Order entered April 25, 2001, to book the CIC payment as a reduction to revenues.

CIC Revisions Filed in Docket UE-011442:

On October 24, 2001, PSE filed a tariff revision to Schedule 125 to reduce the CIC payment from $0.05 per kWh to $0.02 per kWh and requested a waiver of the 30-day statutory notice for an effective date of November 1, 2001. On October 31, 2001, PSE submitted a written request to extend the less than statutory notice effective date to November 8, 2001.

PSE states that it is seeking to change the CIC because market conditions have changed and, therefore, they claim that the program is no longer self-funding. Although not directly stated, the apparent reason for less than statutory notice is the Company's desire to mitigate the purported losses from the CIC program.

Petition to Amend Order in Docket UE-010410:

On September 4, 2001, PSE filed a Petition to Amend Order (Petition) in Docket UE-010410 that proposes to unwind, from May 1, the accounting treatment of the Conservation Incentive Credit from a reduction of revenues to a method where the CIC payments and lost revenues are netted against the wholesale power cost revenue/savings and re-accounted for as a regulatory asset (deferred cost). The balance would then be surcharged to customers through Schedule 120, Conservation Rider, at the conclusion of the CIC program.

In the Petition, PSE proposes to calculate each month's deferral of the CIC program benefit/costs, from May through December 2001, as follows:

Conservation Incentive Credits Paid (vol. x $.05)	$x,xxx,xxx
Plus: Lost Revenue (vol. x $.055/kwh summer or $.06/kwh winter)	x,xxx,xxx
Less: Wholesale revenue/savings (vol. x Mid-C firm)	-x,xxx,xxx
Net deferral for recovery through Schedule 120	$x,xxx,xxx

PSE claims that the deferred balance will be approximately $31,000,000 at the end of December (surcharge balance) if the accounting petition is approved as filed. Staff opposes PSE's Petition to Amend the Commission's Order and requests that the Commission dismiss the Petition for the following reasons:

First, the Petition would result in retroactive ratemaking. PSE is paying customers $.05 per kWh pursuant to an approved tariff. PSE's Petition proposes to retroactively re-account for the $.05 per kWh CIC as a regulatory asset (deferral). The balance would then be surcharged (billed back) to customers through Schedule 120, Conservation Rider.

Second, on April 25, 2001, the Commission approved PSE's commitment in Dockets UE-010409 and UE-010410 to pay a conservation credit and to record the credit on the Company's books as a reduction to revenues. There was never a CIC deferral process proposed by PSE, even though some parties sought some form of a sharing mechanism. Staff believes that upon approval of the Time-of-Day and CIC programs, as requested by PSE, the risks were appropriately balanced: PSE got to keep all power cost savings and additional wholesale margins associated with both the Time-of-Day and CIC programs. PSE committed to pay customers $.05 per kWh for their reduced usage above 10% and customers may have invested in energy savings measures based on their expectation of receiving a billing credit.

Third, Staff does not agree with two elements in PSE's proposed deferral calculation. One, the "lost revenues" are not measurable because, absent the CIC, customers may have reduced their usage beyond the 10% threshold anyway due to community calls for conservation, due to PSE's Time-of-Day program, or for other reason. In other words, by including lost revenues for all CIC volumes in the deferral, PSE is recapturing revenues associated with reduced usage that may have occurred with or without the CIC. The Commission does not currently allow recovery of lost revenues associated with conservation programs recovered through the rider (in part because of measurability problems) and we are not prepared to support a change in that policy for this Petition without looking at other off-setting factors associated with PSE's overall cost-of-service. In addition, one could argue that the first 10% savings should be considered in any "net benefit" calculation. Two, PSE's use of the Mid-Columbia index price as a surrogate for its actual selling/purchase prices in the deferral calculation is inconsistent with cost-of-service ratemaking and Staff opposes this pricing methodology. Looking into PSE's actual selling/purchase prices would entail a detailed analysis of thousands of transactions and a thorough understanding of the Company's wholesale selling/purchasing contracting strategy before, and during, the CIC period.

Finally, the recovery of the deferral through the Conservation Rider, Schedule 120, violates the provisions of the tariff rider itself. The rider only allows recovery of *cost-effective* demand-side management. The Company has indicated that this program would not satisfy that condition. Furthermore, the rider is intended to fund conservation programs that are a part of resource planning, i.e., that result in long-term sustainable savings. The CIC was implemented as a result of temporary market aberrations and poor hydro conditions and rewards short-term curtailment.

<u>Staff Discussions With PSE</u>:

Over the past several months Staff has been in discussions with PSE regarding the CIC program. We indicated our concern about diminishing the message of conservation possibly inferred by customers as a result of significantly altering the credit, especially as we move into the winter peak months. According to the Northwest Power Planning Council, the probability for a power deficit this winter declined from 12 percent to less than 1 percent, in part, due to the great efforts of the region to reduce demand during the past spring and summer. Staff continues to believe that the message of conservation remains of great long-term value to our state and region.

In recognition of reduced wholesale power prices, Staff communicated to PSE that we would support reduction of the credit to $.02 per kWh effective November 1st, if PSE committed to offer new cost-effective residential DSM programs. New cost-effective DSM programs focused on sustainable energy savings would be recoverable through the conservation rider, which is fully funded by ratepayers. While Staff recognizes that some customers may use their incentive credits to buy new efficient end-use measures, we believe a program that directly targets energy efficient measures better enables customers to capture longer-term, sustainable savings. We believe the Company has missed, and continues to miss, a great opportunity to capture cost-effective, persistent, energy savings that would serve their customers and investors as a resource for the future. On October 24th, PSE filed to reduce the CIC to $.02 per kWh, continuing to push for the deferred accounting treatment, with no offer to provide cost-effective residential DSM.

Conclusion:

In order to resolve any issues with regard to the deferred accounting treatment prospectively, Staff does not oppose allowing the Company to revise the CIC to $.02 per kWh, or less, on a less than statutory notice basis from November 8, 2001, forward and accordingly would recommend that the Commission not approve any prospective deferred accounting treatment.

For the foregoing reasons, Staff recommends that the Commission: 1) allow the filing in Docket UE-011442 to become effective November 8, 2001, on less than statutory notice; 2) deny (or in the alternative, set for hearing) Puget Sound Energy's Petition to Amend Order in Docket UE-010410 for the period prior to November 8, 2001; and, 3) take no action, or set for hearing, PSE's Petition as it applies to the period November 8, 2001, through December 31, 2001.