

**BEFORE THE WASHINGTON
UTILITIES AND TRANSPORTATION COMMISSION**

WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,

Complainant,

v.

PUGET SOUND ENERGY,

Respondent.

DOCKET UG-230968

CROSS ANSWERING TESTIMONY

OF

WILLIAM GEHRKE

ON BEHALF OF

JOINT ENVIRONMENTAL ADVOCATES

September 12, 2024

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EXHIBIT LIST

Exh. WG-4T, Cross Answering Testimony of William Gehrke

Exh. WG-5, PSE Emissions for Reference and Preferred Portfolio from Puget Sound Energy's 2023 Gas Integrated Resource Plan and Figure 2.11 from PSE's 2023 Natural Gas IRP Exh.

Exh. WG-6, JEA Responses to PSE Data Requests No. 002, 005, 006, 007, 008, and 009

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I. INTRODUCTION

Q. Please state your name and business address.

A. My name is William Gehrke, and I am a Senior Technical Analyst at the NW Energy Coalition (“NWECC” or the “Coalition”). My business address is 811 1st Ave., Suite 305, Seattle, WA 98104.

Q. Who are you representing in this cross-answering testimony?

A. I am testifying for the Joint Environmental Advocates (“JEA”), which includes Climate Solutions, NWECC, and Washington Conservation Action.

Q. What is the purpose of this cross-answering testimony?

A. My testimony responds to Staff testimony from witnesses McGuire and McConnell.

II. Response to Staff Testimony

Q. What was Staff’s risk sharing mechanism (RSM)?

A. Staff recommended that the Commission require PSE to place CCA costs in base rates in the Company’s next general rate case. In the interim, and as an alternative recommendation if costs are not incorporated into base rates, Staff recommended that the Commission adopt PSE’s risk sharing model subject to a modified earnings test, which contains a cost sharing cap. Staff’s proposed earnings test limits risk sharing to 10 basis points of actual return on equity per year in the compliance period.

a. Risk Sharing Mechanism

Q. What did Staff witness McConnell state about Puget Sound Energy's proposed risk sharing mechanism?

1 A. Witness McConnell stated that mechanism should require PSE to share the
2 financial risk associated with acquiring compliance instruments under the CCA.¹
3 The mechanism should be focused on allowance instrument market financial risks
4 rather than total emission variance risk.²

5 **Q. What is your response to Staff witness McConnell's statement that the RSM is**
6 **meant to share the financial risk of acquiring compliance instruments?**

7 A. JEA disagrees that the risk-sharing mechanism should solely focus on variance
8 risk, that is, the financial risk associated with acquiring compliance instruments
9 that vary in price, because it fails to meaningfully align incentives for PSE and
10 unjustly burdens customers. This approach only continues to facilitate PSE's
11 compliance pathway that is out of line with Washington State energy policies,
12 including the CCA, which are intended to move away from high-emission fossil
13 fuels. Indeed, instead of presenting a plan to reduce carbon emissions, PSE is not
14 planning on reducing emissions significantly over time.

15 JEA is concerned about PSE's approach to CCA compliance. In the
16 Company's most recent integrated resource plan, PSE planned on relying on CCA
17 compliance instruments in the long term, rather than reducing emissions.³ The
18 Company is treating the cost of obtaining those instruments as a pass-through cost
19 and is operating under the expectation that all CCA costs will be passed back to
20 customers.

¹ UG-230968 – Staff Exhibit KM-1T, Page 3, Lines 4-6.

² UG-230968 – Staff Exhibit KM-1T, Page 4, Lines 5-6.

³ Exhibit WG-5.

1 The Company should be incentivized to respond to the price signal for CCA
2 compliance pathways that do not reduce emissions long term. For this reason, JEA
3 has tailored its risk-sharing mechanism to apply to price ceiling unit sales, since
4 this is the highest short-term cost compliance instrument for the CCA. Price ceiling
5 unit sales are the costliest means of short-term compliance, and should not be
6 encouraged as a long-term compliance pathway in Washington. By establishing a
7 risk sharing mechanism around price ceiling units, the Commission is setting clear
8 expectations that using price ceiling units for compliance will results in risk
9 sharing between PSE and customers.

10 Price ceiling units are not addressed by Staff’s proposal to use base rates. In
11 Staff’s alternative proposal, price ceiling units would be averaged out in the
12 average annual cost of compliance metric.

13 **Q. What did Staff state around utility decarbonization and cost burden?**

14 **A.** Staff stated “[b]ecause the cost of the carbon transition will ultimately be reflected
15 in general rates; it will eventually be borne primarily by ratepayers as a function of
16 PSE’s overall cost of providing utility service.”⁴

17 **Q. What is JEA’s response to Staff’s position?**

18 **A.** JEA's stance is that ratemaking is not just about guaranteeing a company’s cost
19 recovery. A public commission’s ratemaking is also intended to ensure rates are
20 just and reasonable and in the public interest, and that the energy system reflects
21 legislative goals. Those standards, along with Washington State’s energy policies,

⁴ UG-230968 – Staff Exhibit KM-1T, Page 4-5.

1 do not dictate that ratepayers will “primarily” bear the costs of the carbon
2 transition. Therefore, there is no economic or policy requirement that a CCA risk-
3 sharing mechanism must narrowly focus on variance risk, as opposed to broader
4 compliance pathway risks.

5 **b. Base Rates**

6 **Q. What is Staff's proposal around placing CCA costs in base rates?**

7 **A.** Staff recommends that the Commission instruct PSE to remove the CCA Tracker in
8 the upcoming rate case and incorporate CCA compliance costs into the Company's
9 base rates.

10 **Q. Why does Staff recommend placing CCA costs in base rates?**

11 **A.** Staff recommends that a CCA cost recovery mechanism adopted by the
12 Commission include a risk-sharing mechanism. Staff contends that base rates
13 adequately incorporate such risk-sharing.⁵ That is, utilities bear variance risk and
14 are adequately remunerated for that risk through the risk-adjusted return on equity
15 in rates.

16 In contrast, Staff states, a tracker does not inherently incorporate such risk.
17 Staff notes that trackers transfer risk onto ratepayers without compensation,
18 remove utility cost control incentives, and add to the Commission's administrative
19 burden. Therefore, Staff suggests that, if CCA costs are kept in a tracker, such
20 tracker must incorporate an RSM.⁶ Staff argues that PSE has yet to provide

⁵ UG-230968 – Staff Exhibit CRM-1T, Page 31, Lines 5-8.

⁶ UG 230968 – CRM-1T – Page 33. Lines 6 – 9.

1 sufficient justification for using a tracker for the CCA beyond the initial
2 compliance period.

3 **Q. What is JEA's position on placing CCA costs into base rates?**

4 **A.** JEA agrees with Staff that the Commission should only approve a CCA cost
5 recovery mechanism with an RSM. JEA would like to note that including CCA
6 costs in base rates is a cost recovery mechanism, and such mechanism should
7 include an assurance of equitable risk-sharing. If the Commission does include
8 PSE's CCA costs in base rates, the costs embedded in base rates should consist of a
9 risk-sharing mechanism based on PSE's anticipated CCA compliance costs. JEA
10 recommends implementing a risk-sharing mechanism of 30% cost sharing for
11 estimated unit costs set at the price ceiling when placed into base rates.

12 **Q. What concern does JEA have with the base rate CCA approach?**

13 **A.** JEA disagrees with Staff that incorporation into base rates is sufficient protection
14 for customers alone. Although the base rate approach could provide short-term
15 customer benefits regarding cost certainty and reduced customer rate volatility,
16 base rates without a crafted risk-sharing mechanism shift the financial risk
17 associated with current and future carbon regulation to customers if emissions are
18 not reduced long term. These risks are multifold.

19 Including CCA costs in the base rates would allow PSE to adjust CCA costs
20 in each multi-year rate case, which could mean ballooning compliance costs in the
21 future if PSE chooses to maintain high emissions. The Company may continue
22 using compliance instruments, even high-cost instruments, with no impact to the
23 Company. PSE is meant to reduce emissions in response to the CCA, not use

1 compliance instruments as the primary compliance path. This is bolstered by
2 Washington's statutory target to reduce greenhouse gas emissions to 95% below
3 1990 levels by 2050. Under a base rate cost recovery approach, over the long term,
4 CCA costs would effectively be a passthrough cost.

5 JEA expects that putting CCA costs into base rates would lead to
6 disagreements over forecasting CCA costs. If CCA costs were placed into base
7 rates, PSE would have every incentive to estimate high CCA costs. This could lead
8 to disagreements between stakeholders in the regulatory process.

9 **Q. What risk is JEA concerned about?**

10 **A.** JEA is concerned with the long-term risk to customers posed by not decarbonizing
11 the natural gas system. JEA is highly worried about the effects on PSE's natural
12 gas customers as available statewide allowances decrease and the cost of
13 compliance pathways that do not reduce emissions long-term becomes more
14 expensive. Customers, particularly low- and moderate- income customers, who are
15 unable to transition to other energy sources will bear the brunt of these costs, while
16 other households have the option to shift from using fossil fuel-based energy.

17 PSE's proposal to rely primarily on compliance instruments for meeting
18 CCA requirements deserves careful consideration given the current trend towards
19 reducing dependency on fossil fuels and the increased attention on carbon
20 emissions. The state of Washington is taking proactive steps to minimize reliance
21 on fossil fuels and decrease carbon emissions across the state. Therefore, the
22 Commission should incentivize the natural gas utilities to gradually decrease
23 emissions over time instead of opting to purchase compliance instruments in the

1 future. This approach is crucial to guarantee a smooth and well-managed transition
2 for all customers while aligning with the state's environmental goals.

3 **c. Earnings Test**

4 **Q. What did Staff state around an earnings test?**

5 **A.** Staff stated that PSE's proposed earnings test is incompatible with equitable risk
6 sharing. As an alternative to PSE's RSM earnings test, Staff witness McConnell
7 suggests that the RSM be subject to a cost-sharing cap of 10 basis points of the
8 Company's authorized return on equity for each year.

9 **Q. What do Joint Environmental Advocates and Staff agree on?**

10 **A.** Both parties oppose PSE's proposal to structure the RSM earnings test. PSE's
11 proposed earnings test requires that PSE generate excessive earnings on average
12 over the compliance period for customers to be eligible for any relief from
13 exposure to CCA compliance cost variance risk. This setup completely disregards
14 PSE's assumption of significant risk and transfers the risk to the customers.

15 **Q. What is the difference between Staff and Joint Environmental Advocates'**
16 **earning mechanisms?**

17 **A.** Staff proposes an earnings test which is structured as a cost cap. Staff's cost cap
18 limits the cost that the Company bears to 10 basis points of ROE per calendar year.
19 Staff's proposed risk sharing mechanism uses PSE's risk sharing mechanism with
20 an alternative earnings test.

21 JEA's proposed risk-sharing mechanism incorporates an earnings test.

22 JEA's earnings test is structured so that any amount PSE contributes cannot result

1 in the Company's annual earnings falling below 50 basis points of the authorized
2 ROE. For more detail on JEA's earnings test mechanism, refer to exhibit WG-6.

3 **Q. Why should the Commission adopt JEA's recommend earnings test?**

4 **A.** The risk-sharing mechanism discourages PSE from utilizing a compliance pathway
5 that centers on compliance instruments with price ceiling units. JEA's earnings test
6 is designed to generate a price signal for the Company, via impacting earnings, if
7 price ceiling units are employed for compliance. This approach allows the
8 Company to maintain a reasonable level of earnings while also signaling the
9 financial impact of utilizing price ceiling units for compliance. It's important to
10 note that price ceiling units are an expensive short-term method of compliance, and
11 their usage would likely result in a significant financial impact on customers' bills
12 without reducing emissions long-term.

13 **III. CONCLUSION**

14 **Q. What are your recommendations?**

15 **A.** The Commission should adopt JEA's risk-sharing mechanism. The mechanism
16 should include a focus on long-term abatement risk, not solely on short-term
17 allowance instrument market financial risks (i.e. "variance risk"). Additionally, the
18 mechanism should ensure that its components, including the earnings test, generate
19 appropriate incentives for the Company to avoid high-cost compliance instruments
20 and to plan for short- and long-term compliance that minimizes risk to customers.

21 **Q. Does this conclude your testimony?**

22 **A.** Yes.