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COMMISSION

May 16, 2003

Ms. Carole J. Washburn
Executive Secretary
Washington Utilities and Transportation Commission
P.O. Box 47250
Olympia, WA 98504-7250

RE: Docket Nos. UE-030311 (Electric Least Cost Planning Rulemaking, WAC 480-100-238), UG-030312 (Gas Least Cost Planning Rulemaking, WAC 480-100-238), and UE-030423 (Chapter 480-107 WAC, Request for Proposals Rulemaking)

Dear Ms. Washburn,

Puget Sound Energy, Inc. ("PSE" or "the Company") is providing these comments on the rulemakings in the above noted Dockets pursuant to the Commission's Notices dated April 18, 2003. At this early stage of the rulemaking process, PSE is providing the same set of comments in each Docket because there are many overlapping principles and questions relevant to the least cost planning and request for proposal processes. We look forward to participating in the joint workshop scheduled for Friday, June 13, 2003.

Introduction

Since the Commission last examined the LCP and RFP rules, there has been a sea change in the electric power industry. Then, the industry was struggling to come to grips with issues related to retail competition and anticipated reliance on purchases from wholesale markets and independent power producers or qualifying facilities under PURPA. In the interim, the State and Commission have reaffirmed their continued commitment to full regulation of retail service. Wholesale markets have proven to be volatile. The business and financial models upon which much of the wholesale marketplace was structured have been questioned and even rejected by some members of the financial community. Capital and credit requirements to support wholesale markets were not widely recognized and even now are not clear. Many market participants are wary of wholesale markets, and service providers must give serious consideration to constructing additional generation of their own to meet future load. At the same time, regulated companies are facing significant challenges to their ability to attract and retain the capital to construct generating plant and to create the debt incurrence capacity that is required to provide the liquidity and credit support facilities necessary to conduct basic day-to-day portfolio management activities.

The ability of regulated companies to finance projects is of critical importance to the public interest because a project or purchase may be shown to be the best option, but there are real service and cost impacts to customers if the transaction is delayed or cannot be financed at a reasonable cost or at all.

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There are a number of new tools available to address the challenges facing the industry, in particular in the area of risk management. Existing law and regulation provide regulated companies little guidance on how to fashion and deploy these tools and the related financial structure essential to their use in a manner that will not invite second-guessing when the companies seek to recover the costs of doing business in this new environment. PSE suggests that in these rulemaking proceedings, it would be helpful for the Commission to fully air the issues surrounding the capital and credit markets as they pertain to resource additions and their implications for these rules.

In general, it would be helpful for the Commission to true up the current LCP and RFP rules to its current thinking on a variety of matters in a manner that helps reduce potential disputes among the parties with varying interests on these issues and that maximizes the ability of regulated companies to conduct business in a manner that will be found prudent for future cost recovery. The LCP and RFP rules should permit regulated companies to make timely and reasonable resource decisions, recognizing that "reasonable" does not mean "perfect," and that such decisions are always made in a context of uncertain and changing conditions.

In order to craft such rules, PSE believes that the parties should grapple with balancing the desire to put in place processes that can be, by their very nature, rigid, time consuming and potentially confining in the face of rapidly changing market conditions and the need of regulated companies for flexibility to effect transactions, the assessment of which may be far more complex than an overly rigid rule might assume. PSE believes that it is ultimately in the public interest to empower regulated companies to take advantage of resource acquisition opportunities as they arise. In short, new rules ought to reflect the new market realities facing the industry.

Least Cost Planning ("LCP")

Having recently filed its proposed final 2003 LCP, PSE believes that the current LCP rule is working reasonably well. There are a number of ambiguities in the rule. PSE would support clarification where such clarification could promote the LCP process and help avoid future disputes between participants in the LCP process. However, PSE believes that it is appropriate to retain a rule that is flexible enough to incorporate new tools and techniques for the process in the future, without the need for further revision to accommodate such changes.

PSE would find it helpful to obtain additional Commission guidance on a number of issues that have been the subject of disagreement under the current LCP rule. For example, the term "least cost" has been interpreted by some participants to mean "least direct cost" (excluding externalities such as environmental or social costs), while others interpret "least cost" to mean "least cost including externalities." Different Commission precedents are invoked to support each position. One of PSE's interests is to engage in resource planning in a manner that reduces the potential for after-the-fact disputes regarding the reasonableness of decisions. In resource planning and acquisitions, PSE believes that it is important to consider environmental impacts and effects, but it is not clear how or whether the Commission expects them to be quantified, or alternatively considered as a qualitative aspect of resource acquisition, and to what extent. One way to address this issue would be to discuss whether regulated companies should be required to dedicate a portion of their portfolio to renewable resources. Similarly, with respect to the RFP rule, the participants could discuss whether the Commission should mandate that companies issue occasional renewable RFPs (and approve such acquisitions notwithstanding potential arguments that they cost more than non-renewable alternatives).

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It would also be helpful for the LCP rule to provide some guidance regarding the place of risk management planning and portfolio diversification. Concepts such as risk management, volatility mitigation and portfolio diversification appear not to be addressed at all by the current rule. It is in the public interest to approach power costs in a manner that can provide reasonable and stable rates to customers over time. PSE believes that the concepts of portfolio diversification, risk management and the critical financial integrity principles that underlie the Company's ability to attract capital, credit support and to execute its day to day portfolio operations should be addressed by any new rule.

More fundamentally, PSE believes the participants should address the questions of how much weight and import ought to be given the planning process, and how much contemporaneous feedback the Commission can provide throughout the planning stages. On the one hand, significant resources go into developing an LCP, models are created or refined, assumptions made, and conclusions developed, in a manner that takes into account a variety of perspectives and tradeoffs through a relatively extensive public process. There could be significant value to a process that results in WUTC approval of the LCP to some degree, such that the modeling techniques, assumptions and conclusions in the LCP will have presumptive weight for purposes of acquisitions (and related rate review). Then, the parties would not be forced to re-argue the same things that have already been decided, and regulated companies would be at reduced risk of being questioned given the benefit of hindsight. Such elements of approval could assist regulated companies in the acquisition process. On the other hand, PSE is concerned that such an approach could increase the contentiousness of the LCP process, delay resource acquisition, and reduce the Company's flexibility at the acquisition stage. As with other issues discussed in these comments, PSE does not claim to have the "right" answer on this issue, but believes the Commission should consider and balance these tradeoffs in this rulemaking.

Chapter 480-107 WAC, Competitive Bidding

PSE believes it is worth recalling that the current rules were developed primarily for PURPA acquisitions from qualifying facilities ("QFs"). Because implementation of PURPA at that time had contemplated that electric service providers would enter into long-term contracts with QFs at the providers' avoided cost, there was a danger that ratepayers would be forced to pay for contracts at some administratively determined avoided cost that was, in fact, a higher cost than could be obtained if QFs (and other potential, competing providers) were forced to bid against each other.

While the scope of the current rule is not limited to issuance of RFPs for QF purchases, the rule explicitly provides that it is not the only means of acquiring resources: "These rules do not preclude electric utilities from constructing electric resources, operating conservation programs, purchasing power through negotiated purchase contracts, or otherwise taking action to satisfy their public service obligations." WAC 480-107-001(1). Nevertheless, it has been suggested that the current rule is far broader, and that the Commission should have an expectation that RFPs filed through the WAC 480-107 process are the preferred vehicle for *all* resource acquisition. PSE believes that the Commission should develop and articulate its current views in this rulemaking about any preferred process for resource acquisitions.

The Commission will still need to address PURPA requirements in this rulemaking. However, PSE recommends that the Commission consider starting from scratch in addressing competitive bidding issues, in the context of the significant changes in the industry described above. Such inquiry should keep in mind that resource acquisition is not typically best performed on the basis of lowest price bids, but rather through much more sophisticated procurement approaches that,

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among other things, preserve a company's flexibility with respect to the resource in the context of its overall portfolio. The rule should also be flexible enough to respond to actual circumstances and information available at the time of the resource acquisition decision.

PSE also recommends that the Commission consider expanding the scope of the RFP rule to extend to acquisition of generation and other resources, but on a voluntary basis. If a company chooses to go through the formal RFP process, then it would seem reasonable for there to be a rebuttable presumption that certain elements of the acquisition of the resource was prudent (at least with respect to size, type, location, etc. even if the Commission reserves the prudence question with respect to implementation of the acquisition). It is noteworthy that a number of other state commissions have moved toward certain "pre-approval" processes for resource acquisitions. The availability of processes that provide contemporaneous feedback such as this could be extremely helpful in the current capital and credit environment.

PSE further recommends that the Commission consider instituting a process by which a ratemaking discussion and decision could be made up front as part of the acquisition process. As the Commission is aware, the settlement that the Commission approved in PSE's latest rate case provides for a power cost only rate case that is designed to adjust rates such that they include the new resource as of the time the resource goes into service. PSE suggests that the Commission investigate whether and how such a tool could be expanded and made more generally available to regulated companies in the future.

With respect to timing, the current rule contemplates that RFPs be issued every two years, in conjunction with a company's LCP. PSE suggests that the current rule be amended to permit regulated companies to issue RFPs under the rule at a timing of the companies' discretion rather than on a set schedule. If possible, the procedure should also be shortened.

Conclusion

Thank you for the opportunity to file these comments. The Company hopes they are helpful to the Commission and other interested parties as we work together to advance the public interest. If you have any questions regarding these comments or if we can be of any other assistance, please contact me at 425-462-3272.

Sincerely,



for: *Director - Regulatory Relations*
George Pohndorf
Director - Regulatory Initiatives