BEFORE THE WASHINGTON UTILITIES AND

TRANSPORTATION COMMISSION

In the matter of the Proceeding to Develop a Policy Statement Addressing Alternatives to Traditional Cost of Service Rate Making.	DOCKET NO. U-210590 Northwest & Intermountain Power Producers Coalition Phase Two Comments

I. INTRODUCTION

The Northwest & Intermountain Power Producers Coalition ("NIPPC") provides these comments pursuant to the Washington Utilities and Transportation Commission's ("UTC" or the "Commission") May 5, 2025 Notice of Workshop and Opportunity to Comment ("Notice"). In the initial phase of this docket three years ago, NIPPC recommended that the Commission address and provide broad policy guidance on the performance incentive set forth in the Clean Energy Transformation Act ("CETA") through which a utility may earn a return on a power purchase agreement ("PPA"). The Notice indicates that the Commission now "seek[s] to identify general guidelines and establish the foundational principles for designing PIMs" – an abbreviation for "performance incentive mechanisms" – in Phase 2 of this docket, requests "general feedback" on PIMs, and asks "[w]hat design approaches or mechanisms should the Commission consider when developing PIMs?"[1] Given that CETA's return-on-PPA provision authorizes development of a specific PIM, that six years have passed since CETA passed, and that three years have passed since NIPPC last recommended that the

[1] Notice at 3-4.

Commission provide guidance on returns on PPAs, NIPPC recommends that the Commission implement this CETA provision in Phase 2 of this docket.

II. COMMENTS

The Notice poses several questions for interested parties stemming from both the Commission's August 2, 2024 Policy Statement Addressing Initial Reported Performance Metrics and an Appendix that the Commission filed along with the Notice.[2] The Appendix explains the Commission's phased approach to the remainder of this docket, indicating that Phase 2 will focus on establishing guidance for PIMs, Phase 3 will examine cost containment strategies, and Phase 4 will establish values for different PIMs.[3] These comments will focus on the legislature's establishment of the return-on-PPA concept, the concept's "fit" in the context of general guidance for PIMs, and why the Commission should take up the issue of PIM's for the establishment of the return-on-PPA concept as soon as practicable.

A. Background

The Commission initiated this docket four years ago. The original schedule for the docket contemplated that Phase 1 would be complete by March 2023, Phase 2 by March 2024, Phase 3 by December 2024, and Phase 4 by December 2025.[4] NIPPC advocated in comments and workshops during Phase 1 for the Commission to take up the return-on-PPA issue in this docket.[5] While not reflected in any written material in the

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2 Appendix A, Updated Work Plan (May 5, 2025).
3 Appendix A at 2.
4 Appendix A at 4.
5 Meeting Summary of April 19 Workshop at 15 (Jun. 8, 2022); NIPPC Phase One Comments (Apr. 27, 2022); NIPPC Comments (Nov. 29, 2021).

docket, NIPPC's understanding from engagement with the Commission and Staff during Phase 1 was that the Commission would consider addressing CETA's return-on-PPA incentive mechanism during Phase 3 or Phase 4, then contemplated for 2024 and 2025 respectively.

However, the Commission then set aside its original schedule. On January 12, 2023, the Commission issued a Notice Temporarily Postponing Proceeding, pausing the docket through April 2023.[6] April 2023 came and went, and it was not until December 13, 2023 that the Commission revived the docket.[7] The Commission then spent much of 2024 developing the Policy Statement referenced above, and only now in 2025 is preparing to launch Phase 2 of the docket (originally expected to be complete over a year ago).[8] The Commission expects that Phase 2 will not be complete until February 2026.[9]

This background provides important context, because a key legislative tool that could and should be explored in this docket has been gathering dust for several years now. Continuing to wait for Phase 3 or 4 of this docket will further delay implementation of a regulatory construct authorized by the legislature until an unknown future date – Phases 3 and 4 are given dates of "TBD" in the Commission's current Work Plan.[10] Perhaps more importantly, though, as will be discussed below, Washington's return-on-

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6 Notice Temporarily Postponing Proceeding at 1 (Jan. 12, 2023).
7 Notice Resuming Proceeding and Opportunity to Provide Written Comments at 1 (Dec. 13, 2023).
8 Appendix A at 2, 4.
9 Appendix A at 2.
10 Appendix A at 2.

PPA incentive mechanism is a good fit for Phase 2 of this docket as outlined in the Notice.

B. CETA Authorizes Utility Returns on PPAs as an Incentive Mechanism

In reshaping key elements of Washington's regulatory construct for electric utilities, CETA established the return-on-PPA construct as part of the law's discussion of performance-based regulation. Section 1(5) of CETA states that the legislature:

> recognizes and finds that the [UTC's] statutory grant of authority for rate making includes consideration and implementation of performance and incentive-based regulation, multiyear rate plans, and other flexible regulatory mechanisms where appropriate to achieve fair, just, reasonable, and sufficient rates and its public interest objectives.[11]

Section 21 of CETA explicitly authorizes the UTC to allow a utility to earn a rate of return on the operating expenses a utility incurs under a PPA.[12] This docket broadly implementing performance-based regulation remains the perfect venue for the Commission to develop specific guidance for utilities to apply CETA's return-on-PPA incentive mechanism.

Specifically, this sort of incentive mechanism is among the more straightforward PIMs that the Commission could provide guidance for in Phase 2 of this docket. The types of PIM details contemplated for later phases include more complicated topics such as "metrics for Outcomes and Goals", "performance baselines", and "performance

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11 2019 Wash. Sess. Laws ch. 288 § 1(5) (codified at RCW 19.405.010(5)).

12 2019 Wash. Sess. Laws ch. 288 § 21 (codified at RCW 80.28.410); *see also* NIPPC Comments at 3-5.

targets[.]"[13] A return-on-PPA PIM, on the other hand, only requires initial guidance from the Commission in Phase 2, and then specific returns may be proposed by utilities on a case-by-case basis and reviewed against the Commission's guidance without the need to establish specific metrics or targets. In fact, since procurement typically occurs as the result of a regulated Request for Proposals ("RFP") process, establishing specific targets could infringe on competition unnecessarily.[14] Instead, simply establishing guidance for proposing a reasonable rate of return for utility investments in PPAs could support the fair selection of the most cost-effective resources to serve customers (as discussed further below) while also fitting into the Commission's broader efforts to establish specific incentives for other desirable utility behavior.

For additional reference, NIPPC attaches a legal memorandum it procured on ratemaking in Washington and how CETA's return-on-PPA incentive mechanism compares to traditional regulation.[15] NIPPC included this memorandum as an attachment to comments submitted in this docket in 2022, but given the passage of time, significant changes to the service list of this docket in the intervening years, and the docket's focus on other matters, NIPPC believes there is value in producing the document again.

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13 Appendix A at 2.

14 *See generally* WAC 480-107.

15 Attachment A, NIPPC, Washington Return on Equity Standards Memorandum (Oct. 7, 2021).

C. A Return-on-PPA Incentive Mechanism Could Provide a Solution to the Utility Ownership Bias and Improve Outcomes for Customers

NIPPC's past engagement in this docket has discussed how a return-on-PPA incentive mechanism could help to mitigate utility ownership bias.[16] This bias occurs because traditional regulation, which focuses on providing a return on a utility's capital investments, does not reward utilities as much for procuring power from third parties as it does for building and owning resources itself.

NIPPC acknowledges that the Commission's competitive procurement rules are intended to provide fair treatment for both utility-owned and third-party resources; however, even a fair selection process is not sufficient to address the fundamental incentive structure that compensates utility shareholders for utility-owned resources but not third-party resources. Thus even with the competitive procurement rules in place, utilities may design RFPs to favor owned resources (on which they will earn a return for their shareholder) over PPAs (on which they will not). Just one example of this is that some utilities do not make utility-owned transmission assets available to third-party bidders. A return-on-PPA incentive mechanism could address this underlying bias, bolster the UTC's competitive procurement rules, and encourage fair RFP design by ensuring that a utility has equal incentives to procure utility-owned and third-party resources.

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16 *See* NIPPC Comments at 5-6. The Regulatory Assistance Project ("RAP") also discusses this bias. *See* RAP, Performance Based Regulation Report at 5 (Mar. 2, 2022).

The Commission's Notice contemplates "promot[ing] a fair balance between utilities' financial rewards and tangible customer benefits[.]"[17] While NIPPC's comments frequently focus on fairness and competition, it is worth underscoring that the ultimate goal of competition is to reduce costs and risks ultimately born by customers. Ensuring an even playing field between utility-owned and third-party resources will encourage utilities to procure the most cost-effective resource for their customers, regardless of ownership. Without the opportunity to earn a return on PPAs, utilities may design procurement processes to exclude cost-effective third-party resources on grounds unrelated to cost, using tools such as minimum bid criteria for interconnection and transmission. With the opportunity to earn a return on PPAs, however, utilities will reduce their incentive to design procurement processes in a manner that preferences utility-owned resources.

D. Without UTC Guidance, CETA May Not Be Implemented

Three years ago, "NIPPC recommend[ed] the Commission provide guidance on CETA's return-on-PPA incentive mechanism because NIPPC [was] concerned that a lack of clarity [would] hinder any implementation of the statutory text."[18] The intervening years have proved NIPPC's concern correct, and NIPPC is unaware of any utility successfully seeking a return on any PPA for a generating resource under CETA's authorization.

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17 Notice at 4.
18 NIPPC Phase One Comments at 5.

While not applying to a generating resource, the Commission found it appropriate to allow Puget Sound Energy ("PSE") to earn a return on three demand response PPAs in its 2024 rate case.[19] These were small contracts, there was no dispute that they were prudently incurred, and demand response is generally less controversial than a traditional PPA. Public Counsel, the Alliance of Western Energy Consumers ("AWEC"), the Joint Environmental Agencies ("JEA"), and The Energy Project ("TEP") all opposed inclusion of a return on the demand response PPAs.[20] The arguments raised by these parties would have had the practical result of precluding returns on PPAs in nearly all circumstances and made the return-on-PPA provision in CETA a dead letter. Staff did not support or oppose the inclusion of a rate of return on PSE's PPAs but argued that the cost of debt is the appropriate rate for the Commission to apply.[21]

After reviewing the record, the Commission concluded that a return on the PPAs should be allowed, but at a relatively low rate:

> PSE did not present a case warranting allowance of the authorized rate of return, specifically why the PPAs in question merit the highest rate of return, and as such, we agree with Staff that the lower end of the spectrum, the cost of debt, is appropriate here.[22]

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19 *Washington Utilities and Transportation Commission v. Puget Sound Energy*/in re Puget Sound Energy For an Accounting Order Authorizing Deferred Accounting Treatment of Purchased Power agreement Expenses Pursuant to RCW 80.28.410, Docket Nos. UE-240004, UG-240005, and UE-230810, Order Nos. 090/07 at P. 200 (Jan. 15, 2025).

20 Docket Nos. UE-240004, UG-240005, and UE-230810, Order Nos. 090/07 at P. 198.

21 Docket Nos. UE-240004, UG-240005, and UE-230810, Order Nos. 090/07 at P. 197.

22 Docket Nos. UE-240004, UG-240005, and UE-230810, Order Nos. 090/07, P. 200.

The Commission did not provide any guidance regarding whether it will allow returns on other PPAs, including those for larger traditional energy or capacity PPAs, what standards it will use when reviewing requests, and what would have been a sufficient record to authorize a higher rate of return.

Washington utilities need further guidance, especially as to what the Commission's position is on the arguments raised against a return on PPAs, what standards it will use to consider returns, and what returns are appropriate under any specific factual circumstance. Given the lack of requests from utilities, NIPPC believes that insufficient direction from the Commission is a key factor why Washington utilities are not using this provision because they do not know whether they will be able to earn a return or how much they will earn. For example, it is unclear whether the Commission will agree with the arguments of parties such as Public Counsel, AWEC, TEP, and JEA that returns should almost never be allowed, and there is little guidance on what type of returns should be expected.

The legislature authorized the return-on-PPA incentive mechanism for a reason – to help "achieve fair, just, reasonable, and sufficient rates and [meet] public interest objectives"[23] – and Commission action is necessary to carry out the legislature's intent.

III. CONCLUSION

For the foregoing reasons, NIPPC respectfully recommends that the Commission establish guidance to implement CETA's return-on-PPA incentive mechanism in Phase 2

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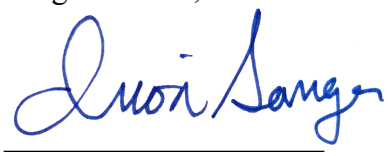
[23] 2019 Wash. Sess. Laws ch. 288 § 1(5) (codified at RCW 19.405.010(5)).

of this docket. NIPPC looks forward to participating in the Commission's June 17 workshop to discuss this matter further.

Dated this 6th day of June 2025.

Respectfully submitted,

Sanger Greene, PC



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Of Attorneys for Northwest & Intermountain Power Producers Coalition

Attachment A

NIPPC, Washington Return on Equity Standards Memorandum

October 7, 2021

Northwest & Intermountain Power Producers Coalition

MEMORANDUM

FROM: Irion Sanger
Joni Sliger

RE: Washington Return on Equity Standards

DATE: October 7, 2021

I. SUMMARY

This memorandum differentiates: 1) a Washington utility's traditional return on equity authorization (or disallowance) and 2) new statutory language in the Clean Energy Transformation Act ("CETA") authorizing a potential return on certain costs associated with power purchase agreements ("PPAs") that are "major projects" in the utility's Clean Energy Action Plan or that win a utility's request for proposal ("RFP"). This memorandum focuses in particular on treatment of investor-owned electric utilities and does not examine publicly owned electric utilities (e.g., public utility districts).

In summary, while the Washington Utilities and Transportation Commission (the "WUTC") has broad authority to set utility rates, so long as a utility meets specific requirements, it is statutorily and constitutionally entitled to recovery, including a non-zero return on and of utility investments. Generally, utilities are entitled to recover but not earn a return on costs other than capital investments. Recent court cases suggest the WUTC tends to err towards approving recovery more often than not. In contrast to the historic approach, CETA authorizes utilities to seek the WUTC's approval of a return on PPA costs (i.e., a return on costs other than capital investments). CETA does not explicitly require the WUTC to grant any return, either on PPA costs or otherwise. Thus, utilities may seek a return on PPA costs, but they are not legally entitled to even an opportunity to earn a return on PPA costs.

The WUTC has not yet made a final decision on how it will implement CETA's authorization. CETA is drafted to provide the WUTC with discretion whether or not to allow a return on a PPA. One question that has arisen is whether the WUTC should simply treat a CETA return similarly to a utility's ordinary return, particularly in evaluating bids in a resource solicitation (i.e., assume parity between the return on a PPA and the return on a utility-owned resource in the quantitative scoring of such bids). This memorandum concludes a parity approach would overlook the fundamental legal distinctions between a utility's right to a return

on its own investments and CETA's authorization of, but no right to, a return on certain PPA costs. Thus, treating a CETA return similar to an ordinary return, would assume parity exists when in fact it does not.[1]

II. DISCUSSION

A. Legal Requirements for WUTC Ratemaking

A primary purpose of government regulation is to protect that government's citizens. Washington State has the sovereign right to regulate private persons for the benefit of the state's citizens, subject to those citizens' constitutional rights, and it has chosen to exercise that right over electric utilities.[2] Washington law obligates electric utilities to provide service that is "safe, adequate and efficient, and in all respects just and reasonable."[3] To enforce the various utility laws, the state legislature has delegated certain powers to the WUTC. Among other tasks, the WUTC must set utility rates so that they are "just, reasonable, and sufficient."[4] In short, Washington law sets a ceiling on the rates a utility may charge, and the WUTC is responsible for ensuring that rates do not exceed this statutory ceiling.[5]

Washington State recognizes another purpose of rate regulation—"assur[ing] that regulated utilities earn enough to remain in business"—as *equally* important to protecting customers from excessive rates.[6] By law, the WUTC must set utility rates so that, in addition to being "just [and] reasonable," they are also "sufficient," which means that the rates "meet the needs of the Company to cover its expenses and attract necessary capital on reasonable terms."[7]

A Washington utility's statutory right to earn a "sufficient" amount in rates reinforces that utility's constitutional rights not to have its private property (including capital investments) put to public use without just compensation.[8] The Supreme Court has held that "[r]ates which

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1 The memo does not address other issues related to CETA's implementation of the return on PPA, including but not limited how the provision can be implemented to reduce utility bias in the resource procurement process.

2 *See People's Org. for Wash. Energy Resources v. WUTC*, 711 P.2d 319, 104 Wn.2d 798, 807 (1985) [hereinafter *POWER*].

3 RCW 80.28.010(2).

4 RCW 80.28.020; *see* RCW 80.01.040(3); RCW 80.28.010(1).

5 *See, e.g., U.S. West Communications, Inc. v. WUTC*, 949 P.2d 1337, 134 Wn.2d 74 (1998) (affirming WUTC decision that, among other things, lowered the telephone utility's rate of return because the WUTC found service was inadequate and unreasonable).

6 *POWER,* 104 Wn.2d at 808 (citing *State ex rel. Puget Sound Power & Light Co. v. Dep't of Pub. Works*, 38 P.2d 350, 179 Wash. 461, 466, (1934)). This 1934 case explained that this dynamic as also necessary to protect ratepayers, albeit future ratepayers.

7 RCW 80.28.020; *WUTC v. Puget Sound Energy*, Dockets UE-190529 and UG-190530 (consolidated), Final Order 08 at P. 71 (July 8, 2020).

8 *See* U.S. Constitution, Amdt. V and XIV; Wash. Constitution, Art. I, Section 16.

are not sufficient to yield a reasonable return on the value of the property used at the time it is being used to render the service are unjust, unreasonable and confiscatory, and their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment."[9] The Washington Supreme Court has expressed its agreement with the U.S. Supreme Court's explanation of these rights:

> A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employes [sic] for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties....[10]

In other words, utilities have constitutional rights that protect them from rates so low as to be confiscatory. The Washington State Constitution provides a state constitutional right that is additional to the federal constitutional right. Further, Washington law provides utilities with statutory rights to sufficient rates that are similarly additional to the utilities' constitutional rights. In summary, Washington utilities have constitutional and statutory rights to rates that allow the utilities to recover certain service-related costs and a return of and on investment costs that is sufficiently high to maintain the utility's financial viability.

Utilities are not entitled to recover all costs, but the prohibitions on cost recovery are specific. First, utilities cannot recover costs unrelated to providing utility service. For example, Washington utilities cannot recover voluntary charitable contributions in rates.[11] Second, a service-related cost is not recoverable if it was not prudently incurred.[12] Third, utilities are not entitled to earn a return on investments that were not "used and useful for service."[13] Note that these requirements essentially parallel the U.S. Supreme Court's description of constitutional rights: 1) the prudent utility is likely one operating "under efficient and economical management"; and 2) a utility's constitutional right to earn a return only on "property which it

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9 *Bluefield Water Works & Imp. Co. v. Public Serv. Comm'n*, 262 U.S. 679, 690, 43 S.Ct. 675, 67 L.Ed. 1176 (1923).

10 *POWER,* 104 Wn.2d at 813 (quoting *Bluefield Water Works*, 262 U.S. at 692).

11 *Jewell v. WUTC,* 585 P.2d 1167, 90 Wn.2d 775, 780-781 (1978) (reversing WUTC decision to allow recovery, when costs were for telephone utility's voluntary charitable contributions).

12 *POWER*, 104 Wn.2d at 810.

13 RCW 80.04.250(2).

employes [sic] for the convenience of the public" is met by a return on property that is "used and useful."

Experts often disagree on what the appropriate rate of return is, and typically vary between a couple percentages (e.g., a recommendation for a 10% return on equity vs. an 8% return on equity). However, there is no question that a utility is entitled to earn a non-zero rate of return on investments that are service-related, prudent, and used and useful.

In summary, so long as a utility incurs service-related costs prudently, it is entitled to rates that permit it to recover those costs. Further, if the utility invests in something "used and useful," the utility is entitled to rates that permit it to earn a return on and of its investment (called "rate base").

B. WUTC Ratemaking Decisions As Applied

Courts can review WUTC decisions, but judges generally defer to the agency's quasi-legislative authority and "are not at liberty to substitute their judgment for that of" the WUTC.[14] Therefore, at least recent court cases generally focus only on whether the WUTC met Washington's procedural requirements for its decision-making process or whether the three standards described above were met (i.e., a cost is service-related, prudently incurred, and, if applicable, was used and useful).[15]

Recent court cases indicate that the WUTC appears to err on the side of ruling in the utility's favor. For instance, around 1978, the WUTC allowed recovery of voluntary charitable contributions; the court reversed because the costs were not service-related.[16] Similarly, the WUTC has allowed recovery of controversial service-related costs, including costs related to an abandoned nuclear power plant and costs related to a potentially unlawful tax.[17]

The WUTC did not allow a return on the abandoned nuclear plant, but the court held that doing so would have violated the used and useful requirement if it had.[18] Notably, a year earlier, a court had reversed the WUTC's decision to allow a return on costs that were not used and

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14 RCW 80.04.170, 80.04.190; *see POWER,* 104 Wn.2d at 812.

15 *See generally* Wash. Admin. Procedure Act, RCW 34.05.001 to 34.05.902.

16 *Jewell,* 90 Wn.2d at 780-781.

17 *POWER,* 104 Wn.2d at 822-823 (affirming WUTC decision to allow recovery of costs related to electric utility's abandoned nuclear power plant), *and Willman v. WUTC*, 93 P.3d 909, 913, 122 Wash.App. 194 (Wash. App. 2004) (affirming WUTC decision to take no action and automatically allow cost recovery where costs regarded Native American tax upon non-Native persons and there was a question as to legal validity of tax).

18 *POWER,* 104 Wn.2d at 822-823.

useful.[19] Also, in 2018, a court reversed another decision for the same mistake, allowing a return on costs that were not used and useful.[20]

The WUTC has sometimes denied recovery, but the circumstances appear to be atypical, such as when a utility actively refuses to provide information, or when the WUTC thinks other states' ratepayers are responsible for the costs (i.e., the costs might be recoverable, but not from Washington ratepayers).[21]

Of recent court cases, only one focused on determining the appropriate rate of return. In that case, a telephone utility filed for a rate increase, but the WUTC instead reduced rates.[22] The WUTC stated somewhat bluntly that the telephone service was both inadequate and overpriced, in part because the utility sold off a lucrative part of its business to an unregulated affiliate for what the WUTC deemed "grossly inadequate" compensation.[23] Also, the WUTC stated it would provide a higher rate of return once service became adequate.[24] The court affirmed the WUTC's decision to set the rate of return at the lowest rate the WUTC found to be reasonable (i.e., 9.367%, a not inconsiderable rate).[25]

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19 *People's Org. for Wash. Energy Resources v. WUTC*, 679 P.2d 922, 101 Wn.2d 425, 426 (1984) [hereinafter *Power I*] (reversing WUTC decision to allow return on costs, where court found recovery violated used and useful statute).

20 *Wash. Attorney General's Office v. WUTC*, 423 P.3d 861, 864 (Wash. App. 2018) (reversing WUTC decision to allow return on costs, where court found recovery violated used and useful statute).

21 *Waste Management of Seattle, Inc. v. WUTC*, 869 P.2d 1034, 123 Wn.2d 621, 624-628 (1994) (reversing WUTC decision to deny recovery of costs, where costs were incurred by company WUTC considered utility affiliate and utility had refused to disclose information, because court found statute obligated WUTC to allow pass-through of specific fees at issue); *PacifiCorp v. WUTC*, 376 P.3d 389, 194 Wash.App. 571 (Wash. App. 2016) (affirming WUTC decision not to change cost allocation methodology regarding costs of out-of-state contracts under the Public Utility Regulatory Policies Act ("PURPA"), effectively denying recovery from Washington ratepayers, where WUTC found costs resulted from different state policies and thus should continue to be allocated to the originating states).

22 *U.S. West Communications, Inc. v. WUTC*, 949 P.2d 1337, 134 Wn.2d 74, 80 (Wash. 1998) (affirming WUTC decision that, among other things, lowered the telephone utility's rate of return because the WUTC found service was inadequate and unreasonable).

23 *U.S. West Communications*, 134 Wn.2d at 80-81, 90.

24 *U.S. West Communications*, 134 Wn.2d at 83.

25 *U.S. West Communications*, 134 Wn.2d at 83. The WUTC set the company's return on equity to 11.3%. *Id.* at 115 n12.

C. Treatment of PPA Costs under CETA

Traditionally, the WUTC has set rates pursuant to the basic formula R = O + B(r), where "R" stands for the revenue requirement, "O" stands for operating expenses, "B" stands for rate base, and "r" stands for the rate of return the utility can earn on the rate base.[26] In other words, the general formula expects that a utility's total revenue will equal the utility's operating costs plus the costs of the utility's investments multiplied by a rate of return on those investments.

Under the traditional ratemaking approach, utilities could recover costs incurred without any utility investment (such as costs under a PPA), as long as the PPA costs were service-related and prudently incurred.[27] However, a utility would not earn a return on such costs in the ordinary course of events. This is because the utility is not making an investment when it incurs costs under most PPAs. A PPA could be structured differently such that a utility is making an investment as part of the PPA. For example, in *WUTC v. Puget Sound Energy* ("PSE"), the WUTC approved a settlement stipulation that allowed a return on at least some costs under a PPA between PSE and Chelan Public Utility District ("PUD").[28] According to Chelan PUD's 2017 financial report, under the PPA, "PSE is generally responsible to pay 25% of all costs associated with the projects, including capital, operation and maintenance and debt service costs, in addition to charges for capital recovery, debt reduction and various fees."[29] PSE has some responsibility for capital investments under this PPA, thus PSE may be entitled to a return on at least some of PSE's costs under the PPA terms. This example underscores the innovative contracting provisions that could be needed for a utility to justify earning a return on (some) PPA costs under the historic ratemaking approach. It is possible that the WUTC may have itself found other valid justifications, but those possibilities are outside of the scope of this memorandum.

CETA officially authorizes the WUTC to allow utilities to receive a return on costs they incur under PPAs that are "major projects" in the utility's Clean Energy Action Plan or that win a utility's RFP.[30] Section 21 of CETA authorizes a change to how utilities treat "costs incurred in connection with major projects … selected in the electrical company's solicitation of bids," including "all operating and maintenance costs, depreciation, taxes, cost of capital associated with the applicable resource or the execution of a [PPA]."[31] The "cost of capital" includes

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26 *POWER,* 104 Wn.2d at 809-10.

27 There can be often factors at play, such as PacifiCorp's multi-state cost allocation for its PURPA contracts. *See supra* note 20.

28 *WUTC v. PSE*, Docket Nos. UE-170033 and UG-170034 *(consolidated)*, Order No. 08 at i (Dec. 5, 2017); Docket Nos. UE-170033 and UG-170034 *(consolidated)*, Multiparty Settlement Stipulation and Agreement, Exhibit G at 2 (Sept. 15, 2017).

29 Chelan PUD, 2017 Annual Report at 20. Chelan PUD's financial reports are generally available on its website at https://www.chelanpud.org/about-us/our-financials/annual-reports.

30 2019 Wash. Sess. Laws ch. 288 § 21 (codified at RCW 80.28.410).

31 2019 Wash. Sess. Laws ch. 288 § 21.

> For the duration of a [PPA], a rate of return of no less than the authorized cost of debt and no greater than the authorized rate of return of the electrical company, which would be multiplied by the operating expense incurred by the electrical company under the [PPA].[32]

Starting on "the effective date of the [PPA]," utilities may "defer for later consideration by the [WUTC]" the above costs for up to three years.[33] CETA explicitly states that "[c]reation of such a deferral account does not by itself determine the actual costs of the resource or power purchase agreement, whether recovery of any or all of these costs is appropriate, or other issues to be decided by the commission in a general rate case or other proceeding."[34] Thus, CETA authorizes utilities to track the above costs and, at any time within roughly three years, seek WUTC's approval to recover those costs.

Notably, this section of CETA does not explicitly authorize or order WUTC to take any action. Thus, CETA authorizes the WUTC, at its discretion, to consider changing the historic ratemaking treatment of a subset of PPAs such that the utility might recover more than its costs alone. If WUTC decides that a return is justified, then CETA mandates that the return be set within a specific range ("no less than the authorized cost of debt and no greater than the authorized rate of return"). However, CETA does not mandate that any return must be authorized, thus it could be zero. It is possible that WUTC might decide a non-return is only justified when the PPA, taken as whole, was imprudently incurred, such that the utility should not recover any PPA costs.

In summary, a utility is entitled to recover prudently incurred service-related costs and to earn a return on and of prudently incurred investments that are used and useful. CETA authorizes the WUTC to allow a return on PPA costs as though they were utility investments. This grant of authority does not provide the same constitutional or statutory right to a return that applies to actual utility investments. Based on the broad discretion that courts provide the WUTC ratemaking decisions, it is unlikely that any court would find legal error if the WUTC refused to approve a return on an RFP-winning PPA, for example, while a court would almost certainly find legal error if the WUTC denied a return on an RFP-winning utility resource, so long as the utility resource was prudently incurred and used and useful.

The WUTC has not yet made a final decision on how it will implement CETA's authorization. CETA is drafted to provide the WUTC with discretion whether or not to allow a return on a PPA. One question that has arisen is whether the WUTC should simply treat a CETA return similarly to a utility's ordinary return, particularly in evaluating bids in a resource

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32 2019 Wash. Sess. Laws ch. 288 § 21.

33 2019 Wash. Sess. Laws ch. 288 § 21. The time period is somewhat qualified by the unclear statement in the law "However, if during such a period the electrical company files a general rate case or other proceeding for the recovery of such costs, deferral ends on the effective date of the final decision by the commission in such a proceeding." *Id.*

34 2019 Wash. Sess. Laws ch. 288 § 21.

solicitation (i.e., assume parity between the return on a PPA and the return on a utility-owned resource in the quantitative scoring of such bids). This memorandum concludes a parity approach would overlook the fundamental legal distinctions between a utility's right to a return on its own investments and CETA's authorization of, but no right to, a return on certain PPA costs.