

**BEFORE THE WASHINGTON
UTILITIES AND TRANSPORTATION COMMISSION**

WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION

DOCKET UG-230968

Complaint,

v.

PUGET SOUND ENERGY, INC.

Respondent.

**POST-HEARING BRIEF
OF PUBLIC COUNSEL**

November 7, 2024

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I. INTRODUCTION

1. The record in this matter confirms that Puget Sound Energy (PSE or Company) has sufficient control over its allowance purchasing strategy, at least as compared to market average, to warrant a risk sharing mechanism to apportion risk from volatile prices and incentivize efficient market participation. Additionally, it is not reasonably disputed that utilities have a wide variety of incentives, tools, and programs that can assist Washington consumers transition toward clean energy, such that a risk sharing mechanism to apportion risk for failing to meet CCA goals and to incentivize PSE to be a champion of energy efficiency is appropriate. The Washington State Attorney General's Office Public Counsel Unit (Public Counsel) witness, Dr. Earle properly noted that the issue of Climate Commitment Act (CCA) allowances is really a two-part equation involving an examination of (1) allowance prices and (2) allowance quantity.¹ The Washington Utilities and Transportation Commission (Commission) should affirm its decision to mandate a risk sharing mechanism to address both price and quantity.
2. Public Counsel asks the Commission to find that PSE's proposal, which is endorsed by Utilities and Transportation Commission Staff (Staff) as a secondary recommendation, is insufficient to incent control of either price or quantity. The Commission should direct the parties to design a risk sharing mechanism that properly incentivizes PSE to manage its allowance purchase prices prudently. With respect to incentivizing PSE to manage the quantity, the Joint Environmental Advocates (JEA) proposal to make ceiling unit allowance purchases has merit and is worthy of serious consideration. Finally, Public Counsel appreciates Staff's

¹ Robert Earle, TR. 155:1-24.

articulation of principles to guide issuance of tracking mechanisms but asks the Commission to conclude that the allowance market is currently too uncertain to incorporate allowance costs into rates.

II. FACTS

3. It is not seriously disputed that CCA allowance prices are subject to volatility. In California, the only other state with a carbon allowance market, there has been significant price volatility, particularly since 2021.² In Washington’s own market, launched in 2023, prices doubled in six months, fell back toward the original price, and then dropped precipitously in 2024.³ Additionally, that volatility is not possible to accurately predict. Because Washington’s market is new, there are no models currently available to provide useful forecasts.⁴ And there are several pending events that will have an uncertain impact on prices including the failed initiative to repeal the CCA, the anticipated linkage between Washington and California’s allowance markets and any adjustments to compliance periods related to that linkage.⁵

4. Although PSE correctly notes its limited ability to control the market price of CCA allowances, in fact, PSE had significant control over its strategy for purchasing and utilizing allowances. First, as admitted in the evidentiary hearing, PSE “can control our activities within the market” and “can make sure that our costs are in line with what market costs are” such that PSE “can try to be, you know, within X percent of whatever the average costs are.”⁶ This is evident from the structure of the CCA market which gives PSE access to auctions, annual

² Cross-Answering Testimony of Robert Earle, Exh. RLE-1CT at 9, Figure 2.

³ Earle, Exh. RLE-1CT at 9:3–4, Figure 3.

⁴ Earle, TR. 143:8–20.

⁵ Chris McQuire, TR. 166:20–167:10.

⁶ Jason Kuzma, TR. 101:3–18.

allowance price containment reserve auctions, no-cost allowances, and the secondary market.⁷

Additionally, the CCA allowances have different vintages, with variable prices for each vintage, adding a layer of purchasing strategy.⁸ PSE can, and does, deploy significant expertise in its market purchase strategy with the express intent to manage costs. As Dr. Earle explained, PSE can control its trading and how its average price compares to the average market price.⁹

5. PSE has another method of limiting CCA allowance costs, which is to manage the quantity of allowances needed through its decarbonization programs. PSE observes that, technically, the success of decarbonization programs rely on customer participation and suggests that relying on customer participation vitiates its “control.”¹⁰ PSE’s concern is overstated; the Legislature has found that, in fact, PSE is “an important partner in helping their customers make smart energy choices.”¹¹ The Legislature determined that PSE could actively support programming to “accelerate the adoption of efficient, nonemitting appliances...improve management of energy loads, better manage integration of variable renewable energy resources, reduce greenhouse gas emissions from the buildings section, mitigate the environmental impacts of utility operations and power purchase, and improve health outcomes.”¹²

6. In practice, as PSE admitted at the hearing, it shares the ability to decarbonize with its customers.¹³ In fact, as JEA witness Lauren McCloy established, utilities like PSE are the

⁷ See e.g. Direct Testimony of Tricia Fischer, Exh. TLF-1CT at 28:1–31:12 (summarizing PSE’s lesson’s learned from 2023).

⁸ See eg. Fischer, Exh. TFL-1CT at 29:13–19 (discussing performance of various vintages).

⁹ Earle, TR. 155:9–13.

¹⁰ Direct Testimony of Matt Steuerwalt, Exh. MS-1T at 9:4–12.

¹¹ ESHB 1589, 67th Leg. Reg. Sess. (Wash. 2024) (Codified RCW 80.86.010, See. Findings—Intent—2024 c 351).

¹² *Id.*

¹³ Steuerwalt, TR. 82:23–85:20.

entities with the most “capital, technological, organizational, and human resources to enact complex plans to reduce its emissions.”¹⁴ As PSE expressly acknowledged, “compliance with the CCA will require complex and multifaceted decarbonization efforts across many industries, including natural gas utilities.”¹⁵ Relying on purchasing allowances is insufficient¹⁶ and prudence demands “efforts to decarbonize at the lowest reasonable cost for customers.”¹⁷ PSE acknowledges the need for its active participation in decarbonization; it is appropriate to encourage that participation with monetary incentives.

7. The need to incentivize PSE toward decarbonization will grow over time. The Legislature designed an expiring no-cost allowance system to facilitate the transition toward decarbonization.¹⁸ Unless PSE makes progress on decarbonization, by 2030, it will need to purchase approximately five million allowances a year, adding from \$277 million to \$504 million in costs.¹⁹
8. The record establishes that PSE’s proposed risk sharing mechanism will create no incentive for PSE to manage the price it pays for allowances. PSE proposes to set sharing bands based on PSE’s deviation from average market price.²⁰ PSE would share part of CCA allowance costs only if its average price exceeded the 75th percentile or 97.5th percentile of prices paid.²¹ Practically, however, these thresholds will never be reached. As Dr. Earle explained in graphic

¹⁴ Response Testimony of Lauren McCloy, Exh. LM-1T at 11:9–12:2.

¹⁵ Rebuttal Testimony of Jason Kuzma, Exh. JK-3T at 3:15–17.

¹⁶ Kuzma, Exh. JK-3T at 3:17–19.

¹⁷ Steuerwalt, TR. 87:19–20.

¹⁸ McCloy, Exh. LM-1T at 8:10–9:13.

¹⁹ Earle, Exh. RLE-1CT at 6:4–7.

²⁰ Direct Testimony of Christopher Mickelson, Exh. CTM-1CT at 4:8–17.

²¹ *Id.* at 15, Figure 2.

terms, a blindfolded monkey would beat these thresholds 99.7 percent of the time.²² Added to PSE's proposal to include an earnings test, PSE's proposal would create zero sharing of risk and no incentive at all.²³ PSE's proposal is a risk-sharing mechanism in name only.

9. The concept of using PSE's performance against the market to incentivize price management is, however, not without merit. Meeting or exceeding average market performance is a well-established incentive system in executive management, profit-sharing schemes, and in equity management.²⁴ An incentive system based on average random trading prices with dead and sharing bands around an average performance could be an effective mechanism for incenting PSE to "control [its] activities in the market."²⁵ Public Counsel did not have sufficient resources to devote to making a specific proposal, but if directed by the Commission, a market average based mechanism could be fashioned into an effective risk sharing mechanism and incentive. The Commission could direct the PSE to modify its proposal to include actual incentives.

10. PSE's conceptual approach to measuring its performance against the market may create an incentive to manage allowance prices, but it does not address the quantity of allowances needed. Here, JEA's proposal, modified per Dr. Earle's critique regarding distribution and discontinuous incentives, shows promise. JEA proposes to create sharing bands for the highest cost allowances, those approaching the ceiling unit price.²⁶ These are allowances Ecology sells at the end of a compliance period after all auctions and reserve auctions are exhausted.²⁷ As the

²² Earle, TR. 147:1–6.

²³ *Id.* at 148:14–19.

²⁴ Earle, Exh. RLE-1CT at 25:6–7.

²⁵ Earle, Exh. RLE-1CT at 25:22–26:16; Jason Kuzma, TR. 101:3–18.

²⁶ Response Testimony of William Gehrke, Exh. WG-1T at 23:2–10.

²⁷ *Id.* at 10:19–11:6.

number of auctioned allowances decrease over time, this effectively means that unless PSE is able to decarbonize, it will have to increasingly share the purchase of expensive allowances.²⁸ PSE would need to plan its decarbonization strategies to reduce emissions to avoid sharing the price ceiling units.²⁹ As with PSE’s proposal, however, JEA’s mechanism would be ineffective at incentivizing PSE to manage its allowance purchase strategy.³⁰

III. STANDARD OF REVIEW

11. The Commission is empowered to set rates that must be fair, just, reasonable, and sufficient.³¹ The Commission’s obligation is to balance consumer and investor interests.³² When rates are unfair, the Commission is expressly empowered to fix them.³³ The Commission has already addressed the need for a risk sharing mechanism to accomplish that balancing task here, concluding that PSE’s CCA tariff “places all of the risks associated with CCA compliance on PSE’s natural gas customers” and directing PSE “to develop a risk-sharing mechanism that appropriately balances the compliance risk between the Company and its natural gas customers.”³⁴ The Commission need not rely on express statutory authority in the CCA itself; its power to deploy ratemaking tools to balance consumer and investor interests is contained in its

²⁸ Gehrke, TR. 171:15–172:7.

²⁹ *Id.* 174:22–175:4.

³⁰ Earle, Exh. RLE-1CT at 9–13.

³¹ RCW 80.28.020; *Wash. Utils. & Transp. Comm’n v. Puget Sound Energy, Inc.*, Dockets UE-090704 & UG-090705 (*consol.*), Order 11, ¶ 18 (Apr. 2, 2010) (emphasis added).

³² *U.S. West Commc’ns, Inc. v. Wash. Utils. & Transp. Comm’n*, 134 Wn.2d 74, 121 (1997).

³³ RCW 80.04.020.

³⁴ *Wash. Utils. & Transp. Comm’n v. Puget Sound Energy, Inc.*, Docket UG-230470, Order 01, ¶ 22 (Aug. 3, 2023).

existing statutory authority to set fair rates. Risk-sharing mechanisms have been in the Commission’s rate-making toolbox for 20 years.³⁵

12. The Commission should reject PSE’s argument that the CCA does not contain express authority to use a risk sharing mechanism.³⁶ The Commission should likewise reject PSE’s interpretation of the legislative history of the decarbonization bill which initially had a risk sharing provision.³⁷ The Legislature did not need to award the Commission the discretion to use ratemaking tools it already had. If anything, the decarbonization bill expressly recognized that decarbonization requires careful and integrated planning as the state implements the CCA and recognizes the need for deployment of “new regulatory tools.”³⁸ The CCA itself directs “coordinated, comprehensive, and multisectoral implementation of policies, programs, and laws, as other enacted policies are insufficient.”³⁹ In both the decarbonization bill and the CCA, the Legislature has indicated its intent to use all existing tools to accomplish the transition to clean energy.

13. Under Commission precedent, risk sharing mechanisms are well-established rate making tools with two purposes. The first, is to allocate variability risk between shareholders and ratepayers.⁴⁰ Second, where a utility has some ability to control costs, a risk sharing mechanism can incentivize effective cost management.⁴¹ A risk sharing mechanism seeks to “achieve an

³⁵ *Wash. Utils. & Transp. Comm’n v. Puget Sound Energy Inc.*, Dockets UE-011570 & UG-011571 (*consol.*), 12th Supp. Order ¶¶ 23–24, (June 20, 2002) (adopting a risk sharing mechanism for power costs under its general authority).

³⁶ *See eg.* Steuerwalt, Exh. MS-3T at 4:4–7.

³⁷ *Id.* at 3:8–9:2.

³⁸ ESHB 1589, 67th Leg. Reg. Sess. (Wash. 2024) (Codified RCW 80.86.010, See. Findings—Intent—2024 c 351).

³⁹ RCW 70A.65.005(2).

⁴⁰ *Wash. Utils. & Transp. Comm’n v. Avista Corp.*, Docket UE-060181, Order 3, ¶ 23 (June 16, 2006) (discussing the adoption of a power cost risk sharing mechanism).

⁴¹ *Id.*

appropriate balance between risks to customers and risks to utility shareholders” both to provide a utility an incentive to control costs and to promote rate stability.⁴² The record in this case establishes both that there is variability risk and that PSE has some degree of control over both the price it pays for allowances and the quantity of allowances that PSE will need in the future, making a risk-sharing mechanism appropriate.

IV. ARGUMENT

14. In 2023, the Commission properly identified the need for a risk-sharing mechanism. The record in this case confirms that there is a risk in variability both in price and quantity of CCA allowances and a risk sharing mechanism is appropriate. Unfortunately, PSE’s proposal is inadequate to that purpose and should be rejected, and the Commission should require PSE to resubmit its market-based proposal to reflect a mechanism that would actually share risk and incentivize PSE to manage costs. The Commission should also strongly consider JEA’s proposal to align PSE’s cost management incentive with the CCA’s goal of gradual decarbonization. The Commission should not put CCA costs into rates, as it is not currently possible to accurately forecast CCA allowance prices.

A. A Risk Sharing Mechanism is Appropriate

15. Initially, the Commission should affirm its earlier determination that a risk-sharing mechanism is appropriate in the context of the CCA. There is significant volatility in allowance prices and given the shrinking number of allowances available, there is significant risk that PSE’s need for allowances will exceed supply. As the Commission recognized, a risk sharing

⁴² *Wash. Utils. & Transp. Comm’n. v. Puget Sound Energy Inc.*, Dockets UE-011570 & UG-011571 (*consol.*), 12th Supp. Order ¶¶ 23–24, (June 20, 2002).

mechanism should “share risk such that all parties are encouraged to reduce their emissions, and in turn, the costs required for CCA compliance.”⁴³

16. The Commission should also conclude that PSE had sufficient ability to control both price, at least with respect to average market performance, and quantity to achieve the secondary goal of incentivizing PSE to increase efficiency. PSE admits its ability to control its purchasing strategy and to keep costs close to the market average.⁴⁴ And although PSE attempts to place all decarbonization on consumer decisions, in reality, PSE has multiple tools to encourage and assist consumers on the path to clean energy. PSE needs to deploy those tools in an efficient, timely, and cost-effective manner. Creating an incentive to reduce emissions accomplishes that goal without requiring the Commission to be directive.

B. The Commission Should Reject PSE’s Proposed Mechanism and Direct the Parties to Design Sharing Bands That Will Create Actual Incentives.

17. As a risk-sharing mechanism, PSE’s proposal is wholly insufficient and should be rejected. The concept of using PSE’s performance compared to average market performance could be effective, but PSE’s design fails to create any incentive. By setting the average percentile price threshold too high, PSE effectively insulates itself from any incentive or risk.⁴⁵ If redesigned to create effective sharing bands around the performance of an average CCA allowance trader, the concept could be fruitful.⁴⁶ The Commission should direct PSE and the parties to resubmit a market performance-based mechanism that would create actual incentives.

⁴³ *Wash. Utils. & Transp. Comm’n v. Puget Sound Energy, Inc.*, Docket UG-230470, Order 01, ¶ 22 (Aug. 3, 2023).

⁴⁴ Jason Kuzma, TR. 101:3–18.

⁴⁵ Earle, Exh. RLE-1CT at 25:22–26:16.

⁴⁶ *Id.* at 9–13.

18. Although disappointing, this result is not wasteful or unjust. This adjudication fruitfully permitted close examination of PSE’s proposal. Examining such proposals and modelling in the context of a specific record sharpens the debate in a way that a policy docket does not permit. Since PSE’s Schedule 111 has been approved on an interim basis, subject to refund, the risk to the Company from the ongoing matter is minimal. Public Counsel submits that the Commission can direct the parties to refine proposals for a risk sharing mechanism either in this Docket, the open policy docket, or a future rate proceeding. As a practical matter, the Commission has until the conclusion of the first CCA compliance period in 2027 to approve a risk sharing mechanism for CCA compliance. Obviously, the sooner a mechanism is ordered, the sooner PSE can begin implementing it. But the need is not so dire that the Commission should accept a patently inadequate mechanism.

C. The Commission Should Give JEA’s Proposal Serious Consideration.

19. As noted above, JEA’s proposed mechanism is also insufficient to motivate PSE to manage allowance purchases to minimize prices paid. Focusing, as it does, on only the most expensive allowances, it would permit PSE to trade inefficiently for the four years of the compliance period. If the Commission adopts JEA’s proposal, PSE should still be directed to craft a price-focused sharing mechanism.

20. As a mechanism to motivate PSE to decarbonize, however, JEA’s proposal has some elegance. In the early years, with relatively large auction allowance numbers and large numbers of no-cost allowances, its impact is negligible as PSE has not, and will not purchase ceiling price units.⁴⁷ Accordingly, JEA’s proposal’s initial impact would be on PSE’s planning process,

⁴⁷ Gehrke, TR. 173:19–25.

incentivizing PSE to be aggressive in designing and deploying decarbonization programs. As the cap on emissions declines over time, it will align both PSE shareholder and ratepayer interests toward reducing the quantity of allowances necessary for compliance with the CCA cap. Ceiling units will be needed primarily if PSE lags its decarbonization targets to meet the CCA's shrinking cap on emissions, thus incenting PSE and its shareholders to truly partner with customers to reduce emissions. JEA's proposal leaves PSE with significant discretion for identifying and pursuing the most cost-effective means of decarbonization for its customers. The Commission should give JEA's proposal serious consideration.

D. The Commission Should Reject Staff's Proposal to Embed CCA Costs into Rates.

21. Public Counsel takes no position on the test that Staff proposes to evaluate the need for a separate tracking mechanism. Public Counsel shares Staff's dissatisfaction with the proliferation of tracking docket. Tracking mechanisms should be the exception rather than the rule. Whether considered as extreme volatility or as a separate factor, however, the problem with placing CCA costs into rates is that there is no current method for accurately projecting CCA costs.⁴⁸ Without an accurate forecast, PSE and intervening parties would be forced into guessing at what CCA costs will be the future. Aside from violating Commission precedent about the analytical rigor required for projecting future costs,⁴⁹ the process would be unmanageable for the Commission. PSE would project high costs to ensure that it was over-collecting in order to pay for future CCA allowances. Public Counsel and other consumer advocates would project low costs to avoid that result, and the Commission would have no objective way of setting a "fair" baseline rate. It may

⁴⁸ Earle, TR. 143:8–20.

⁴⁹ *Puget Sound Energy*, Dockets UE-090704 & UG 090705 (*consol.*) Final Order 11 ¶ 26 (Apr. 8, 2010).

be possible in the future to project CCA allowance costs with sufficient certainty to include them in rates. At this point, however, the unknowns are too great.

V. CONCLUSION

22. This Docket has been helpful in creating a factual record upon which the Commission can base a decision about the adequacy of risk sharing mechanisms. Rather than accepting an inadequate proposal or closing the Docket, the Commission can and should direct PSE to redesign its proposal to reasonably apportion risk according to PSE's ability to meet average market performance. The Commission should also seriously consider ordering PSE to adopt JEA's proposed sharing bands for price ceiling units as this would align PSE's interests fully with those of customers and would encourage PSE to apply itself fully to the challenges of transitioning to a clean energy economy. Finally, at least for now, the Commission should decline Staff's invitation to place CCA allowances directly into rates.

DATED this 7th day of November 2024.

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