BEFORE THE WASHINGTON
UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, Petitioner, v. PUGET SOUND ENERGY, Respondent.	DOCKET UG-230968 **JOINT ENVIRONMENTAL ADVOCATES' POST-HEARING BRIEF**

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I. INTRODUCTION

1. The Washington State Legislature signaled our need to quickly and equitably reduce greenhouse gas emissions through a panoply of bills. The Climate Commitment Act ("CCA") is one such law, relying upon a flexible but ambitious financial mechanism to incentivize emissions reductions from covered entities. Puget Sound Energy ("PSE" or "the Company") has structured its tariff in this docket to evade the CCA's price signals and have customers foot the bill entirely for allowances that cover the Company's emissions. Climate Solutions, NW Energy Coalition, and Washington Conservation Action (collectively "Joint Environmental Advocates" or "JEA") submit this brief to the Washington Utilities and Transportation Commission ("UTC" or "Commission") to support the adoption of JEA's proposed risk-sharing mechanism, which aligns PSE's incentives with state statutory requirements and fairly balances risk between the Company and customers.

II. REGULATORY BACKGROUND

2. The CCA, enacted in 2021, creates a statewide greenhouse gas emissions cap that decreases every three years, with the eventual target of a net-zero carbon footprint and a 95% reduction from 1990 emissions levels by 2050.[1] To incentivize emissions reductions, the CCA establishes a cap-and-invest system for regulated entities that came into effect in 2023, whereby covered entities must pay to emit by obtaining allowances at auction (and may obtain a small proportion of offsets). Per Ecology rule, auction floor and ceiling prices increase annually by 5% plus inflation.[2]

[1] RCW 70A.65.060.

[2] WAC 173-446-335(2) and (5).

3. To limit impacts on customers, a special provision for gas utilities like PSE provides them allowances at no cost based on calculated baseline emissions.[3] In the first year of the program, gas utilities receive allowances that cover 93% of their emissions allocation baseline, but the amount declines proportionally with the statewide cap over time. Beginning in 2023, 65% of the no-cost allowances allocated to gas utilities must be auctioned to benefit customers, at a minimum eliminating additional cost burdens to low-income customers that result from implementation of the CCA.[4] These benefits may take the form of bill credits or weatherization and efficiency services, among other options. The percentage of allowances that must be auctioned increases by 5% each year until it reaches 100%.[5]

4. Allowance costs will increase over time due to mandated annual increases in auction prices and due to decreased supply as no-cost allowance allocations to utilities decrease and the cap-and-invest program cap decreases.[6] By reducing emissions, entities reduce the number of allowances they must purchase and reduce exposure to volatility and price increases in the state carbon market.

III. DOCKET BACKGROUND

5. In June 2023, PSE filed a tariff revision in Docket UG-230470 for the compliance period of August through December 2023 that would allow the company to recover CCA

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[3] RCW 70A.65.060, .120-.130.

[4] RCW 70A.65.130(1)(d).

[5] RCW 70A.65.130(2)(a).

[6] Ecology's models predicted allowance prices of $50-100 per metric ton of CO_2 equivalent by 2030, depending on various factors such as linkage with other carbon markets or ACPR frontloading. *Final Summary of Market Modeling and Analysis of the Proposed Cap and Invest Program*, Dep't of Ecology (Sep. 2022), at p. 4, https://apps.ecology.wa.gov/publications/documents/2302010.pdf.

allowance costs and pass back auction proceeds directly from and to customers.[7] The tariff filing was slated to increase the net gas revenue requirement by over $16 million (3.23%), with typical residential ratepayers seeing rate increases of approximately 3.89%.[8] PSE did not provide detailed justification for its treatment of the tariff as a pass-through cost to customers, other than stating that doing so was mandated under the CCA and that customers were responsible for emissions rather than the utility.[9]

6. The Office of Public Counsel, Climate Solutions, NWEC, The Energy Project, and Washington Conservation Action expressed concerns that PSE failed to risk share; these parties and Staff recommended the docket be adjudicated.[10] The UTC approved the tariff but issued several stipulations, three of which are relevant here. First, the tariff approval was not precedential; second, all costs recovered through the tariff were subject to further review and possible refund in a future proceeding; and third, the Commission required PSE to work with parties in the CCA workshop series (Docket U-230161) and with its Low-Income Advisory Group to develop a risk-sharing mechanism.[11] As justification for this third requirement, the Commission stated that PSE's proposed tariff:

> inappropriately places all the risks associated with CCA compliance through allowances on PSE's natural gas customers. … The CCA is meant to serve as a price signal to both utilities and their customers, encouraging both to modify their behavior to reduce carbon emissions. The mechanism should share risk such that all parties are encouraged to reduce their emissions, and, in turn, the costs required for CCA compliance.[12]

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[7] PSE's Natural Gas Tariff Filing, p. 1, UG-230470 (June 9, 2023).

[8] Order 01, ¶ 5, Docket UG-230470 (Aug. 3, 2023).

[9] PSE's Natural Gas Tariff Filing, pp. 1-2, UG-230470 (June 9, 2023).

[10] *See* Order 01, ¶¶ 7-8, 11-14, 16, Docket UG-230470 (Aug. 3, 2023).

[11] *Id.* ¶¶ 17-18, 22-23.

[12] *Id.* ¶ 22.

7. Two sessions of the CCA workshop series considered the matter of risk-sharing. Environmental advocates proposed a mechanism that linked risk to the relationship between PSE's allowance budget and actual emissions.[13] PSE spoke at the workshops and submitted written comments that it should not risk-share and that it was premature to consider risk-sharing parameters.[14]

8. On November 22, 2023, PSE filed a tariff revision for the 2024 calendar year that continued the pass-through treatment of CCA costs and proceeds, and proposed allocating a proportion of no-cost allowance revenue to fund decarbonization projects from 2024-2026.[15] As part of its filing, PSE resubmitted a document purporting to be a "risk-sharing mechanism" that reiterated the Company's position that it should not have to develop a risk-sharing mechanism, but that "because it is required to do so per Order 01" it could include something regarding decarbonization targets in its next IRP.[16]

9. Given the inadequacy of PSE's filing, the Commission suspended the tariff for adjudication.[17] JEA timely moved to intervene in this docket and filed responsive and cross-answering testimony that challenged PSE's risk-sharing approach and Staff's modified proposal

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[13] *See* Comments of Climate Solutions and NWEC, Docket U-230161 (Oct. 17, 2023).

[14] *See* Comments of Puget Sound Energy, Docket U-230161 (Dec. 15, 2023).

[15] PSE's Natural Gas Tariff Filing, Docket UG-230968 (Nov. 22, 2023).

[16] Compliance Filing of Puget Sound Energy, ¶¶ 3-4, 34-35, submitted in Docket UG-230470 (Oct. 31, 2023) and resubmitted in Docket UG-230968 (Nov. 22, 2023) (hereinafter "Compliance Filing"). The resubmission is conspicuous in that it does not update relevant facts, such as the risk-sharing discussion at the fourth CCA workshop session on November 8, 2023. *See id.* ¶ 2. JEA notes that the upcoming 2025 natural gas IRP has been consolidated with various other dockets and the Company will instead produce a 2027 integrated systems plan (ISP) pursuant to HB 1589. *See* Order 01, Dockets UE-240433/UG-240434 (July 11, 2024).

[17] Order 01, ¶¶ 7-16, UG 230968 (Dec. 22, 2023).

as inadequate for the Commission's purposes.[18] All parties participated in an evidentiary hearing on October 9, 2024. JEA now submits this brief to support the adoption of its revised risk-sharing proposal by detailing why risk-sharing is required, how PSE and Staff's proposals fail to adequately risk-share, and why JEA's proposal best meets the CCA, utility regulation principles, and the Commission's objectives in this docket.

IV. THE CCA AND REGULATORY POLICY MANDATE THAT PSE HAVE A STAKE IN CCA IMPLEMENTATION BY SHARING RISK

10. Ordering a risk-sharing mechanism that incentivizes emissions reductions ensures that PSE's CCA compliance strategies are prudent, in the public interest, and aligned with state law. PSE's current approach is that "the Commission should be satisfied that the law is producing its intended results"[19] even where the Company does not plan to reduce emissions and simply acquires allowances[20]—in direct contrast with PSE's claims to the legislature that the CCA would drive "deep and swift" reductions in natural gas.[21] PSE has structured its compliance pathway to ensure that the law does *not* produce its intended results, by ensuring the Company

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[18] *See* Climate Solutions, NW Energy Coalition, and Washington Conservation Action's Petition to Intervene, Docket UG-230968 (Dec. 18, 2023); McCloy, Exh. LM-1T; Gehrke, Exh. WG-1T; Gehrke, Exh. WG-4T.

[19] Steuerwalt, Exh. MS-1T, 6:20-21.

[20] PSE's own emissions trajectory indicates it would be emitting 82% of the statewide emissions cap by 2050. Gehrke, Exh. WG-1T, 19:11-18. PSE indicated in the evidentiary hearing and in its rebuttal that the IRP is outdated or not reflective of PSE's actual emissions planning, *see* Kuzma, Exh. JK-3T, 4:12-7:5; Kuzma, Tr. 94:10-18. But the Company offered no other evidence about its plans that would enable parties or this Commission to understand its alternate CCA compliance plan, if one exists, that is not reliant on long-term allowance purchases. And though PSE argued its IRP was artificially limited by regulatory factors and least cost considerations, *id.*, the Company overstates the limitations of IRP inputs. In fact, WAC 480-90-238 enables utilities to consider lowest *reasonable* cost (not absolute "least cost") for providing service while assessing various factors such as "public policies regarding resource preference" and "risks associated with environmental effects including emissions of carbon dioxide."

[21] *See* McCloy, Exh. LM-1T, 8:16-9:1 (citing to PSE testimony at Senate Ways & Means Committee Public Hearing).

has no decarbonization incentive and that customers inequitably bear the risk. Pass-through treatment of CCA costs is inappropriate because it undermines the purpose of the CCA and contradicts central tenets of utility regulation in the public interest.[22]

A. Pass-Through Treatment Undermines the CCA's Price Signals to Covered Entities to Incentivize Emissions Reductions.

11. The purpose of the CCA is undisputed by parties. PSE recognizes that the CCA is a "comprehensive market-based mechanism aimed at reducing greenhouse gas emissions from large emitters."[23] As detailed extensively in the testimony of Lauren McCloy, the CCA is carefully structured to send price signals to regulated entities to incentivize emissions reductions, with these signals increasing in strength over time.[24]

12. The CCA regulates high-emitting entities rather than individuals for good reason. Utilities have far greater capacity than customers to plan for, incentivize, and drive emissions reductions.[25] These measures include, but are not limited to:

1) Providing incentives and financial assistance to customers to electrify;
2) Providing incentives and financial assistance to customers to weatherize and increase energy efficiency;
3) For dual fuel utilities like PSE, integrating gas and electric-side planning to facilitate the transition to electrification,
4) Researching and acquiring alternative fuels where appropriate, such as to continue supplying hard-to-decarbonize sectors;

[22] *Cf.* Order 01, ¶ 22, Docket UG-230470 (Aug. 3, 2023) (recognizing pass-through treatment is "inappropriate[]").

[23] Kuzma, Exh-JK-1T, 27-8.

[24] *See* McCloy, Exh. LM-1T, 6:7-14, 8:16-9:5, 10:11-12:4; *see also* Steuerwalt, Exh. MS-3T, 6:19-21 (describing the cap-and-invest program as a means to price externalities, *i.e.*, emissions, to change market behaviors).

[25] *See* McCloy, Exh. LM-1T, 11:9-15, 13:7-15; Gehrke, Exh. WG-1T, 18:2-19:9, 20:13-21.

5) Reducing emissions linked to utility operations, such as decarbonizing PSE buildings, heavy machinery, and transportation vehicles and minimizing emissions from pneumatic devices, blowdowns, and other events related to natural gas maintenance[26];
6) Addressing leakage in the distribution system and assessing potential for transition rather than maintenance or creation of new fossil fuel infrastructure.

The wide array of measures available—as well as existing national electrification trends showing strong uptake when provided incentives[27]—disprove PSE's contention that it can do nothing about customer emissions, and that customers should therefore bear the brunt of utility compliance pathway choices.[28] And PSE's position is contrary to state policy that utilities and regulators should facilitate a shift to decarbonization.[29]

13. The CCA recognizes that energy costs might increase as emissions externalities become priced in to entities' operations and aims to minimize or eliminate the burden through no-cost allowances.[30] But that provision of the CCA does not imply that customers are solely responsible for allowance purchase costs, as PSE contends.[31] Potential increases in energy costs could arise for various reasons, including a utility's investments in emissions reductions measures.[32] The legislature recognized that a clean energy transition will require investments—investments that Washingtonians can eventually reap in the form of abundant and affordable

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[26] *See* EPA, Methane Mitigation Technologies Platform, https://www.epa.gov/natural-gas-star-program/methane-mitigation-technologies-platform.

[27] *See* Washington Energy Decarbonization Pathways Report, p. 65, Docket U-210553 (Oct. 2023).

[28] *See* Steuerwalt, Exh. MS-1T, 11:3-16.

[29] *See, e.g.*, Washington Energy Decarbonization Pathways Report, p. 13, Docket U-210553 (Oct. 2023); *see also* HB 1589 (PSE's decarbonization planning requirements).

[30] *See* RCW 70A.65.120(1), .130(2).

[31] *See* McCloy, Exh. LM-1T, 8:5-9, 10:11-18.

[32] *Id.* 8:12-9:13, 10:11-18.

renewable energy, cleaner air, and a livable climate. How PSE chooses to structure its compliance has vastly different outcomes for the environment and for customers, and for this reason an incentive mechanism is necessary to improve those outcomes.

14. If PSE chooses to direct funds in the long-term towards acquiring allowances, it undermines the emissions-reducing intent of the CCA and does virtually nothing to change customer behavior.[33] This choice pollutes customers' indoor air, contributes to climate change, and ensures more customers are locked into propping up a shrinking gas system and its stranded assets.[34] As no-cost allowances phase out and allowance supply decreases, the increased cost of allowances will be passed on to customers, and fewer credits will be directed to mitigate that cost for low-income customers.[35] That increased burden is at odds with the CCA's requirement to eliminate cost burdens to low-income customers and to protect customers from significant rate increases.[36] The outcome of PSE's allowance pathway choice is that customers will be paying for their utility's decision to evade state policy goals and remain on a system that is bad for customers' health, their environment, and ultimately for their pocket.

15. Structuring incentives for PSE to direct funds towards decarbonization and electrification measures rather than allowance purchases would most align with CCA goals and provide customer benefits. The resulting rates would reflect multiple public interest goals: the

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[33] *See id.* 13:7-12 ("[A] significant proportion of residential customers cannot effectuate a transition on their own that would meaningfully reduce emissions. … For these customers, price increases do not act as 'signals' because they do not change behavior, they only impose a financial burden that must be shouldered.").

[34] *See* Steuerwalt, Tr. 85:21-86:11 (discussing shrinking gas system and costs to ratepayers).

[35] *See* Kuzma, Exh. JK-1T, 31:6-18 ("[A]s the allocation declines there will eventually be insufficient no-cost allowances to eliminate the burden to low-income customers.").

[36] RCW 70A.65.130(2)(a); *see also* Kuzma, Exh. JK-1T, 31:14-17 ("[T]he intent of the design of the Climate Commitment Act is to help protect customers of natural gas LDC utilities from potential rate increases resulting from … participation … in the Cap-and-Invest Program.").

dual-fuel utility will continue having a strong customer base, and customers will benefit from better indoor air quality, high-efficiency space and water heating that requires less overall energy input, and abundant and affordable low- or zero-emissions energy.

16. The utility as an entity regulated by the CCA must experience the price signals created by that law; those price signals are intended to incentivize the Company to align its operations with state environmental policy. PSE argues risk-sharing would diminish price signals that encourage customers to address their individual emissions. But that argument belies the central mechanism by which the CCA functions and the fact that the utility is the best-placed and most capable to transition operations and lower emissions, not customers. And PSE's argument contradicts its own position to this Commission that *it* is the regulated entity that bears risk, and its statements to the legislature that the "cap will drive deep and swift reductions in natural gas and the current structure ensures those do not harm [its] customers."[37] PSE's argument that the CCA mandates pass-through treatment is therefore unpersuasive and contrary to the CCA's structure and intent.

B. Requiring Risk-Sharing Fulfills Central Tenets of Utility Regulation in the Public Interest.

17. The Commission is entrusted with the obligation to regulate utilities in the public interest to ensure just, fair, reasonable, and sufficient rates that are consistent with the provisions of the law.[38] These utilities provide important services but enjoy a near-monopoly and captive customer base and thereby require additional oversight to compensate for a lack of market competition. Washington statute provides a non-exhaustive list of public interest factors for the

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[37] *See* McCloy, Exh. LM-1T, 8:16-9:1 (citing PSE testimony in a Senate Ways & Means Committee public hearing).

[38] RCW 80.28.010(1), .020.

Commission to consider, including "environmental health and greenhouse gas emissions reductions, health and safety concerns, … and equity."[39] The Commission may direct specific actions or pathways for utilities to comply with statutory and equitable obligations. Squarely within the Commission's purview, therefore, is a risk-sharing mechanism that incentivizes emissions reductions by ensuring the utility receives price signals from the CCA—mirroring the incentives felt by a covered entity operating in a competitive market—and that ensures customers are not burdened entirely with the risk of a utility's compliance choice pathway.

18. Nowhere does the CCA foreclose the cooperation of agencies or the Commission to use regulatory tools and orders to promote rapid and equitable emissions reductions. In fact, the legislature stated that meeting Washington's greenhouse gas emissions goals would "require coordinated, comprehensive, and multisectoral implementation of policies, programs, and laws."[40] Therefore, Commission orders that promote the goals of the CCA are appropriate regulatory tools used pursuant to the CCA's mandate and the Commission's authority to regulate in the public interest.

19. Moreover, a Commission order to risk-share is necessary to fulfill the CCA's purpose. As PSE states (and JEA agrees), "the legislature affirmatively assigned *associated risks to utilities, not customers*."[41] But PSE limits those risks to the risk of incurring noncompliance penalties pursuant to RCW 70A.65.200 and the risk of disallowance by this Commission through

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[39] RCW 80.28.425 (relating to multiyear rate plans but indicating that consideration of the public interest is applicable to other rate filings).

[40] RCW 70A.65.005(2).

[41] Compliance Filing, ¶ 23 (emphasis added); *see also* Steuerwalt, Exh. MS-1T, 5:2-5 (stating the CCA "place[s] the compliance obligation for greenhouse emissions associated with the combustion of natural gas on the … utility and not on individual commercial and residential customers.")

prudence review.[42] That framing of risk ensures PSE assumes virtually none because the Company has the regulatory expertise and various auction opportunities to ensure it obtains sufficient allowances on the auction market.[43] PSE's framing ignores two significant forms of risk that customers are exposed to, even though it acknowledges them elsewhere[44]: the risk of PSE overpaying for compliance, and the medium- and long-term risk of stranding customers on volatile gas and increasingly-expensive allowances rather than decarbonizing.

20. PSE essentially argues that it is already burdened with the risk of obeying the law and spending prudently, and that should be sufficient in the eyes of this Commission. It is not. The Commission is required to exercise its regulatory authority where a utility knowingly subjects its customers to serious risks and structures its operations to evade state policy. Though PSE contends that pass-through treatment ultimately benefits customers because it reduces the cost of capital for the utility,[45] it ignores the serious negative impacts of pass-through. First, the utility lacks cost control incentives.[46] Second, the utility lacks any incentive for thoughtful medium- and long-term planning in the face of *predictable* increases in auction market volatility and prices—not to mention gas price volatility since 2021 and uncertain and expensive alternatives such as RNG and hydrogen.[47] Currently, customers enjoy bill credits, which frees up

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[42] Compliance Filing, ¶¶ 22-23.

[43] See Kuzma, Exh. JK-1T, 41:18-21 ("In short, compliance APCR auctions and price ceiling unit sales ensure that a covered entity, such as PSE, should never be in a situation in which it cannot procure compliance instruments necessary for compliance [or must procure them] at exorbitant prices on the secondary markets."); Gehrke, Exh. WG-1T, 14:2-15:21.

[44] *See* Martin, Exh. JLM-1CTr, 11:13-12:4 (recognizing a likely increase in volatility of compliance costs as no-costs allowances are reduced and eliminated).

[45] *See generally* Shipman, Exh. TAS-1T.

[46] *See* Earle, Exh. RLE-1CT, 17:7-18:17; *see also* Shipman, Tr. 107:8-108:4 (stating pass-through does not pose urgent incentive to utility).

[47] *See, e.g.*, Compliance Filing, ¶ 26 (recognizing RNG sells at a premium).

space for the utility to pursue investment in decarbonization that lowers future compliance costs and risk exposure.

21. PSE has repeatedly foot-dragged and has been unwilling to engage with the development of a risk-sharing mechanism amenable to all parties. Regulated entities have had since CCA enactment in 2021 to begin planning how to meet their obligations under the Act and to further its goals. And PSE was permitted to structure its first tariff filing for 2023 as a pass-through on the condition that it worked with stakeholders to elaborate an appropriate risk-sharing mechanism for this year. PSE only developed its insufficient proposal after the matter became adjudicated in this docket, and then continued to argue in its testimony and during the evidentiary hearing that it should not be required to adopt a mechanism. PSE has also stated that it should be allowed to continue discussions in the policy docket, U-230161, to determine whether to adopt a mechanism and how to design it,[48] but the Company has not made any efforts to progress in that docket. In fact, in the workshop session specifically addressing risk-sharing, PSE used its time to resist the entire concept, rather than help elaborate what it might look like. In this docket, PSE has not conferred with parties to develop a mechanism or in good faith attempted to seek clarification about proposals where it may have been confused. For instance, PSE argues that the non-company Parties' proposals are "indecipherable and unworkable" despite having ample opportunity to discuss the matter with other parties and to use data requests for further detail.[49] Yet stunningly, PSE claims that this adjudication took away valuable time to

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[48] *Id.*, ¶ 5.

[49] Mickelson, CTM-4T, 1:19-20. JEA notes that PSE sent only one set of DRs to JEA, which JEA replied to. PSE requested no further information or clarification. *See id.* 6:10-21.

work on the issues.[50] Failing to adopt a risk-sharing mechanism, or adopting PSE or Staff's mechanism, will ultimately reward PSE for hindering the regulatory process.

22. It is evident that a risk-sharing approach is necessary to incentivize PSE to comply with the CCA and to accomplish the Commission's goal of ensuring just, reasonable, and equitable rates by sharing relevant risks. Moreover, adopting a risk-sharing mechanism in this docket is essential to ensure PSE takes responsibility for its compliance obligations. It will send a message that the utility is best off cooperating in the regulatory process. This in turn incentivizes PSE, going forward, to participate fully and in good faith in the ongoing CCA policy docket and future CCA-related dockets which would benefit all parties—including the regulated utility. Therefore, far from being "premature,"[51] it is imperative to adopt a risk-sharing mechanism at this stage.

V. PSE'S AND STAFF'S PROPOSED RISK-SHARING MECHANISMS ENSURE THAT PSE WILL BEAR NO RISK.

23. PSE's purported "risk-sharing mechanism" is grounded in the same rationales that initially drove it to file the tariff as a pass-through,[52] and similarly does not meet requirements for fair and equitable rates. JEA, Office of Public Counsel, and Staff agree that PSE's approach is inadequate and inequitable because it is structured to shield from, rather than share in, CCA risk.[53]

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[50] Kuzma, JK-3T, 7:12-13.

[51] Compliance Filing, ¶ 4.

[52] *See* Mickelson, Exh. CTM-1CT 3:8-11 (explaining that PSE did not choose a performance incentive model because CCA costs are pass-through).

[53] *See* Gehrke, Exh. WG-1T, p. 14:2-17:11; McConnell, Exh. KM-1T, 6:17-7:12; Earle, Exh. RLE-1CT, 17:2-3 (applying critique to Staff's proposal but noting it is adopted from PSE's proposal).

24. The Company's proposal essentially subsidizes the Company's emissions through ratepayer-funded allowances, with no corresponding incentive to PSE to modify operations in customers' medium- and long-term interests. Its approach is contrary to the state's environmental policy goals and the Commission's stated goals for the mechanism to encourage emissions reductions.[54] PSE ignores the reality of resource disparity (in terms of who can most effectively reduce gas system emissions) and ensures higher exposure of customers to increasing volatility and rates in the medium- and long-term. A compliance pathway centered on allowance acquisition will drive PSE to rely on price ceiling unit purchases, or near-ceiling units, to comply.[55] Furthermore, the likelihood of triggering risk-sharing under PSE's proposed mechanism is 0.3% at the 75th percentile and zero at the 97.5th percentile of average market price.[56] It would take "almost unbelievably egregious behavior" for PSE's proposed sharing bands to have an effect.[57] Adding PSE's strictly limited earnings test reduces that likelihood even further.[58]

25. Staff's RSM proposal, which largely borrows PSE's approach,[59] also fails to meet the Commission's stated objectives because it does not address the underlying reasons that PSE's CCA compliance choices pose concerning risks. Staff focus on the risk of "upward price

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[54] *Compare* Order 01, ¶ 22, UG-230470 (stating the mechanism should "share risk such that all parties are encouraged to reduce their emissions") *with* Steuerwalt Tr. 88:2-6 (stating that PSE's risk sharing mechanism does not include an incentive for the Company to decarbonize, and should not).

[55] *See* Gehrke, Tr. 171:13-172:6.

[56] Earle, Exh. RLE-1CT, 18:1-11.

[57] Earle, Tr.146:5-11; *see also id.* 147:1-3 (noting sharing would "only kick in if PSE's purchase of allowances is worse than 99.7 percent of blindfolded monkeys").

[58] *See* Mickelson, Exh. CTM-1T, 22:5-23:3.

[59] *See* McConnell, Exh. KM-1T, 4:4-5:16.

excursions,"[60] but do not explore why those excursions would occur and how to disincentivize them. Besides market fluctuations, the very structure of the cap-and-invest market is that allowances will trend upwards in price over time because of decreased supply and because of statutorily-mandated increases in floor and ceiling prices. Thus the upward price excursions in question are not simply a matter of short-term choices PSE makes when purchasing allowances, but also medium- and longer-term choices PSE makes to expose itself to the market when it chooses between purchasing allowances or reducing emissions. Therefore, Staff's proposed model also fails to properly define and manage the risk posed by PSE's CCA compliance pathway choices, despite recognizing that "express public policy broadly directs PSE's strategic decision-making in its carbon emissions market activity."[61]

VI. THE COMMISSION SHOULD ADOPT JEA'S MODIFIED RISK SHARING MECHANISM.

26. Among the proposals offered in this docket, JEA's mechanism, detailed below, best addresses both components of the Commission's requested risk-sharing mechanism: "it share[s] risk such that all parties are encouraged to reduce their emissions, and, in turn, the costs required for CCA compliance."[62] JEA's proposed model recognizes that PSE's compliance pathway choices are a central source of risk, and that risk should be shared by the utility.[63]

27. JEA initially proposed a risk-sharing mechanism in which PSE bears 30% of the unit cost for allowances priced above the 97.5th percentile, with PSE's risk bounded by an

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[60] *Id.*, 7:4-6.

[61] *Id.*, 8:19-21. Such policy is found not only in the CCA, but also in other statutes such as RCW 80.28.024 (expressing preference for renewable energy) and planning requirements in HB 1589.

[62] Order 01, ¶ 22, UG-230470.

[63] As noted above, PSE's 2023 IRP demonstrates plans to buy allowances and make small reductions in emissions by investing in high-cost, uncertain, and risky investments in alternative fuels as part of its CCA compliance portfolio.

earnings test that limited sharing only to situations where the Company earned within 50 basis points of its return on equity.[64] The underlying rationale was to dissuade purchase of the most expensive allowances because not only are these imprudent, but as allowances become scarcer, the likelihood of PSE needing to resort to near-price ceiling purchases will increase unless decarbonization is seriously pursued.[65] JEA's proposal balanced customer and utility interests by including an earnings test and a moderate level of risk sharing near the price ceiling, and providing that utility shareholders would not be negatively impacted as long as the utility stayed on an appropriate decarbonization trajectory.[66]

28. In the course of this proceeding, JEA recognized it could make adjustments to ensure a more robust mechanism that better accomplishes the CCA's and this Commission's goals. Specifically, Public Counsel critiqued the statistical methodology used to establish sharing bands,[67] the discontinuous increase in penalty at the sharing band threshold and a failure to address costs below the 97.5^{th} percentile, and ambiguity over the treatment of allowance units purchased above the ceiling price.[68] Public Counsel also emphasized that risk was two-pronged: there is a risk from price and a risk from quantity. Public Counsel's witness noted that the price risk—PSE's purchasing behavior compared to the market average—was not addressed in JEA's proposal.[69]

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[64] Details of the mechanism are contained in Gehrke, Exh. WG-1T and its attached exhibits.

[65] *Id.*, 26:1-12, 29:16-30:6.

[66] *Id.*, 26:13-28:19, 29:16-30:18.

[67] Earle, Exh. RLE-4C.

[68] Earle, Exh. RLE-1T, 21:6-24:2.

[69] *Id.*, 6:9-11, 24:9-10.

29. JEA agrees that both forms of risk should be addressed, but that the quantity risk resulting from PSE's potential failure to decarbonize remains the most significant concern to address with a risk-sharing mechanism at this stage.[70] This is because the medium- and long-term economic and environmental impacts of reliance on allowances are significant, must be disincentivized as soon as possible, and can be harder for a regulator to assess in prudence review once the Company has put itself in a position to *require* purchasing expensive allowance units in order to stay in compliance with the CCA. JEA's revised proposal, detailed below, ensures that PSE is provided with appropriate incentives to address relevant risks that can harm customers, and that it can do so by adjusting a factor squarely within its control[71]: its choice of compliance pathways.[72]

30. JEA therefore recommends that the Commission adopt its risk-sharing mechanism to address PSE's compliance pathway choice, with the following modifications to JEA's initial proposal:

1) Sharing band thresholds will be determined using the direct calculation of percentiles of market prices rather than assuming a normal distribution[73];

[70] Disincentivizing the purchase of high-cost allowances also addresses price risk to some extent. Earle, Tr. 156:18-157:1.

[71] In making this point, JEA is not conceding that risks must be completely within a utility's control in order for the utility to bear that risk. A central principle of public interest regulation is that *customers* be protected from undue risk. Like all businesses, utilities face risks outside of their control but have the opportunity to earn returns on their investments. In all cases, the regulator must balance the interests of utilities and customers. Regardless, in this context, utilities have significant agency over emissions reductions and cannot therefore argue that decarbonization risks are outside of their control.

[72] *Cf.* Compliance Filing, ¶ 28 (PSE arguing that risk-sharing is inappropriate because the Company lacks control over compliance costs).

[73] *See* Exh. RLE-8X (describing distribution of prices use percentiles of secondary market data rather than normalized distribution).

2) An additional sharing band, dubbed "band beta," will be created between the 90th percentile and 97.5th percentile to create a more continuous penalty structure. PSE will share 10% of unit costs in band beta;

3) A clarification that any allowance units purchased that exceed the price ceiling will be reviewed in the following manner: the difference between the actual price and the price ceiling will be deemed imprudent and borne by the Company, and the remaining unit price will be treated as a price ceiling unit pursuant to JEA's mechanism.[74]

JEA also recommends that the Commission adopt, at the end of this compliance period, an added component to the risk-sharing mechanism that has been developed to address Public Counsel's price risk concerns related to PSE's market performance.[75]

31. JEA's proposal carefully balances state environmental directives, Commission orders, and customer and utility interests. Far from "reduc[ing] the resources available to the Company to implement innovative decarbonization and electrification endeavors,"[76] a risk-sharing mechanism will ensure those resources are directed beneficially rather than be wasted on long-term allowance coverage. If PSE diligently pursues emissions reductions, the mechanism will not affect the Company's return on equity. Meanwhile PSE will reduce its own and customers' exposure to carbon market risk and will further state emissions and equity goals.

VII. CONCLUSION

32. A risk-sharing mechanism addressing abatement risk best aligns with the intent of the CCA and with this Commission's order, and appropriately balances the interests of the utility and its customers. Therefore, JEA requests that this Commission adopt JEA's risk-sharing

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[74] *See* Gehrke, Tr. 176:5-20.

[75] *See generally* Earle, Exh. RLE-1CT; Earle, Tr. 155:1-13.

[76] Compliance Filing, ¶ 29.

mechanism as outlined in the testimony of William Gehrke with the modifications specified in this brief.

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Respectfully submitted,

/s/ *Noelia Gravotta*
Noelia Gravotta (WA Bar No. 60089)
Jan Hasselman (WA Bar No. 29107)
Earthjustice
810 Third Avenue, Suite 610
Seattle, WA 98104
T: (206) 641-9240
ngravotta@earthjustice.org
jhasselman@earthjustice.org
Attorneys for Joint Environmental Advocates