BEFORE THE WASHINGTON UTILITIES AND

TRANSPORTATION COMMISSION

In the matter of Puget Sound Energy's Proposed All-Generation Sources Request for Proposal	DOCKET NO. UE-200414 NORTHWEST & INTERMOUNTAIN POWER PRODUCERS COALITION COMMENTS

I. INTRODUCTION

The Northwest & Intermountain Power Producers Coalition ("NIPPC")[1] appreciates this opportunity to submit comments to the Washington Utilities and Transportation Commission (the "Commission") on Puget Sound Energy's ("PSE's") Proposed All-Generation Sources Request for Proposals ("Proposed RFP"). PSE's Proposed RFP is the first to occur after enactment of new statutory language from the Clean Energy Transformation Act ("CETA") regarding a utility potentially receiving a rate of return on power purchase agreements ("PPAs") that win the RFP bid. The Commission has not previously had the opportunity to establish guidelines on how it will implement CETA's encouragement of PPA acquisitions through a rate of return. NIPPC recommends that the Commission issue guidance on this subject, both for PSE's RFP and

1 NIPPC is a trade association whose members and associate members include independent power producers ("IPPs") active in the Pacific Northwest and Western energy markets. The purpose of NIPPC is to represent the interests of its members in developing rules and policies that help achieve a competitive electric power supply market in the Pacific Northwest. NIPPC's members include IPPs which may bid into PSE's Proposed RFP. NIPPC is committed to fair and open-access transmission service, cost effective power sales, consumer choice in their energy supply, and fair, competitive power markets in the Northwest and adjacent markets.

for the benefit of future resource planning. Ultimately, NIPPC believes allowing a reasonable return on PPAs in the proper circumstances can lead to significant improvements in competitive procurement practices, but only if it is implemented clearly.

NIPPC provides these comments in the hopes that they aid the Commission and PSE in designing a fair and competitive RFP. In these comments, NIPPC provides: 1) a brief summary of why allowing a utility to earn a return on PPAs has the potential to benefit ratepayers; 2) suggestions on how PSE can improve its Proposed RFP's treatment of this subject; and 3) starting principles the Commission should adopt to guide this and future RFPs. NIPPC emphasizes that PSE's Proposed RFP is an opportunity to provide initial guidance, but this proceeding should not be construed as a conclusive implementation of CETA's encouragement of PPA acquisitions through a rate of return. In NIPPC's view, these comments and any subsequent Commission order are only the beginning of a longer conversation. Adaptations will likely be required as the Commission, utilities, and stakeholders gain first-hand experience with implementing CETA's new provision.

II. COMMENTS

A. Background on CETA's Rate of Return Provision

Section 21 of CETA states, in relevant part:

> (1) An electrical company may account for and defer for later consideration by the commission costs incurred in connection with major projects . . . selected in the electrical company's solicitation of bids for delivering electric capacity, energy, capacity and energy, or conservation. . . . . Creation 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.

> (2) The costs that an electrical company may account for and defer for later consideration by the commission pursuant to subsection (1) of this section include all operating and maintenance costs, depreciation, taxes, cost of capital associated with the applicable resource or the execution of a power purchase agreement. Such costs of capital include:
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> (b) *For the duration of a power purchase agreement, 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 power purchase agreement.*[2]

In plain language, Section 21 envisions the following sequence of events: 1) a utility issues an RFP; 2) a PPA resource wins the RFP; 3) the utility executes the PPA and agrees to pay the PPA prices to the Seller for delivered energy and/or capacity; 4) a utility defers PPA costs, including a return to the utility, for later inclusion in rates; and 5) at some point, in a utility's general rate case "or other proceeding," the Commission decides if the utility may recover some or all of the deferred costs from ratepayers. The statute requires the Commission to take action after the RFPs are issued; it does not preclude the Commission from providing guidance on expected ratemaking treatment and the level of the rate of return *before* PSE's Proposed RFP is issued.

NIPPC understands the purpose of Section 21 to be to reduce the utility ownership bias. NIPPC believes that it is not productive to debate whether investor-owned utilities are biased in favor their own resources, or whether utility earnings expectations are at the bottom of that bias. Many resources that would otherwise be in

[2] CETA, 2019 c. 288 § 21 (codified at RCW 80.28.410) (emphasis added).

the interests of utility customers specifically or society generally do not now provide the utility with earnings or other financial incentives, and these facts require the sort of policy intervention that the Washington state legislature enacted in CETA's encouragement of a rate of return on PPAs. Absent policy intervention, it can be difficult for non-utility resources to overcome the utility's bias in favor of its own resources. The issue now before the Commission is not whether there is a bias, but how to overcome it while keeping the interests of utility customers in mind.

NIPPC has commented extensively on this utility ownership bias, most recently in the Commission's rulemaking to update its utility procurement rules.[3] NIPPC noted in those comments that CETA's encouragement of PPA acquisitions through a rate of return is "a welcome change that *could* better ensure that the utilities acquire the least-cost and least-risk generation resources."[4] Success is not guaranteed. Guidance from the Commission is necessary to achieve Section 21's purpose, which is to ensure ratepayers obtain the least-cost, least-risk resources and are not unduly harmed by the electric utility bias to own electric generation rather than enter into PPAs with IPPs.

NIPPC understands the Commission may hope that utilities will propose viable proposals for implementing Section 21. However, in this case, PSE has not yet made a detailed proposal in this Proposed RFP, which illustrates the need for Commission action.

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3 *In re Amending, Adopting, and Repealing WAC 480-107, Relating to Purchases of Electricity*, Docket No. UE-190837, NIPPC Comments at 1-4, Attachments A-D (Mar. 13, 2020) (discussing the utility ownership bias and incorporating NIPPC's comments from the Commission's earlier related rulemaking, specifically Docket No. UE-161024).

4 *Id.* at 2 (emphasis added).

B. PSE's Proposed RFP Does Not Transparently Implement CETA's Rate of Return Provision

PSE's Proposed RFP includes a cursory discussion of the possibility of a rate of return being assigned to PPA bids. Rather than encouraging a level playing field for PPAs, PSE proposes that the unspecified "cost adder" act to disadvantage PPAs in the RFP. This should change.

Specifically, PSE states the following:

> Respondents should be aware that the quantitative cost screening of proposals received in response to the All-Source RFP will include costs associated with delivering the energy to PSE's system as well as the costs associated with financial and accounting regulations. *PSE's analysis will include a cost adder for PPAs*, consistent with rules set forth by CETA and codified in Chapter 80.28.410 RCW . . . .[5]

This raises at least three concerns: 1) there should be no specific "cost adder" in the RFP because that would be counterproductive to purpose of allowing a return on a PPA; 2) if allowed, PSE has not demonstrated what specific number would be appropriate; and 3) PSE is not guaranteed to recover any costs, but only a deferral and an opportunity for recovery; thus, without pre-approval by the Commission any cost adder should be zero.

First, the reason for allowing utilities to earn a return on a PPA is to mitigate the well-established bias that utilities have against utility ownership. This bias can be difficult to quantify, but it exists. One way to address the problem would be to include specific penalties or cost adders to bids that contemplate utility ownership. In other

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[5] PSE, 2020 All-Source RFP for Peak Capacity Resources at 13 (May 4, 2020) (emphasis added).

words, to reduce the incentive, impose a cost adder for utility ownership options. The legislature decided to take a different approach, and instead addressed this bias by providing an incentive for utility ownership. As this incentive for PPAs is designed in large part to offset an existing, but not quantifiable, incentive for utility ownership, the Commission should simply assume that they offset each other by refusing to allow PSE to include its cost adder.

If PSE is allowed to include a cost adder, then the practical effect will be to penalize PPAs in the RFP process by making them look more expensive, rather than to equalize the playing field. In the end, PSE's approach will effectively make it more difficult for PPAs to win RFPs and result in fewer PPAs, which is exactly the opposite goal of CETA.

Second, the level of the utility's rate of return on a PPA is not established in the statute; it is to be set by the Commission within a broad range.[6] It could be as low as PSE's "authorized cost of debt" or be as high as PSE's "authorized rate of return."[7] Further, these amounts could change over the life of the PPA. If PSE intends to use the "cost adder" as a *quantitative* scoring element, it raises the question of what amount PSE intends to use. PSE's Proposed RFP does not say.[8] Transparency is key to successful RFPs, so, at minimum, PSE should identify and justify the level of the rate of return it

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[6] In fact, the Washington State Legislature considered having a specific number and rejected that idea. *Compare* SB 5116 § 22(3) (proposed substitute bill adopted during Feb. 18, 2019 Ways & Means Committee meeting but ultimately not enacted) ("a rate of return of six and one-half percent on the costs incurred by the electrical company under a power purchase agreement"), *with* CETA, 2019 c. 288 § 21(b).

[7] CETA, 2019 c. 288 § 21(b).

[8] *See* PSE, 2020 All-Source RFP for Peak Capacity Resources at 13.

intends to use for purposes of calculating the "cost adder" in its quantitative cost-screening analysis.

Third, PSE is not guaranteed to receive the rate of return on every PPA. CETA allows PSE to *defer* the costs of a rate of return on a PPA, but the Commission retains authority to decide whether or not PSE will *recover* the costs of rate of return on any given PPA from ratepayers. Thus, the rate of return on the PPA is not a guaranteed element of rates paid by PSE's ratepayers. So long as the costs are uncertain, PSE should not consider *any* return in its quantitative scoring analysis. Including costs that may or may not be incurred will only act to penalize PPA bids in the competitive RFP process. NIPPC recommends that PSE not consider the potential rate of return on PPA costs in the RFP process. To the extent the rate of return on PPA costs is considered at all in the RFP, it should be reserved solely for consideration of PSE's short-list, not in the initial screening.

NIPPC recognizes that tension exists between: 1) protecting ratepayers from rate of return on PPAs that could make a winning PPA more expensive than another bid; and 2) providing PSE sufficient certainty that it will obtain rate of return on a PPA such that the intent of the CETA provision succeeds in reducing the utility ownership bias. If the Commission does not reject the concept of a PPA cost adder out of hand, then NIPPC recommends that the Commission prohibit PSE from assuming there will be a rate of return on a PPA in its RFP, *unless* the Commission is prepared to declare that utilities will *always* receive at least some return on a winning PPA bid.

If the Commission is prepared to declare that utilities will always receive at least some return on a PPA, then NIPPC recommends that the Commission require utilities to use the minimum return authorized by statute—the utilities' "authorized cost of debt"[9] as a cost adder. Further, NIPPC recommends that the Commission determine that utilities should expect to recover at least the utility's *current* authorized cost of debt. While PSE's authorized cost of debt could fall, it seems unlikely that PSE's current authorized cost of debt will ever exceed PSE's future authorized rate of return; in other words, the current number will almost certainly meet CETA's requirements.[10] In addition, using a current number that has already been approved by the Commission will avoid the need for utilities to forecast changes in the return on the PPA for purposes of a cost-screening analysis. Forecasting could be especially difficult where, as in PSE's RFP, the maximum PPA length is not specified;[11] PSE could need to make multiple forecasts, depending on the varying lengths of each PPA bid into the RFP. Forecasting will only introduce uncertainty and the possibility of mistakes or manipulation.

Aside from the appropriate level of the return (%) on the PPA, another important issue to address is the amount against which the calculate the return. Calculating the utility's full authorized rate of return against the full revenue charged to the utility under the PPA could likely result in a high return that disadvantages PPA bidders in an RFP. While each state has its own slightly different formula, generally, under traditional ratemaking for a rate-based plant, the rates are established by the following formula: revenue requirement = A&G + O&M + Depreciation + Taxes + ((Rate of Return) * (rate base)), where "A&G" are administration and general expenses, and "O&M" and

9 CETA, 2019 c. 288 § 21(b).
10 If it does not, a future proceeding would be the proper venue for resolution.
11 *See* Comments of Swan Lake and Goldendale at 3 (July 1, 2020).

operations and maintenance expenses. Importantly, the rate of return only applies to the undepreciated capital (rate base) and not to the whole revenue requirement of the plant. Therefore, applying the utility's full authorized rate of return to an entire revenue paid to the IPP under the PPA could place PPA bidders at a competitive disadvantage if it is used for the purposes of a "cost adder" in the RFP. Additionally, with the rate-based plant, in early years (when largely undepreciated) the total cost of service (total revenue requirement) might be about half operations expense and half the carrying cost (rate of return) of the investment, but the impact of the return diminishes over time as the rate base is depreciated. As this discussion demonstrates, the Commission will need to think carefully to approximate the incentives for utility ownership through a return assessed to the PPA revenue, or some portion of it.

In summary, NIPPC recommends that the Commission prohibit PSE from using the proposed "cost adder". Alternatively, NIPPC recommends that the Commission order PSE to state its currently authorized cost of debt in the RFP and use only that amount in considering any "cost adder" in PSE's cost-screening analysis.

NIPPC makes these recommendations for the purposes of PSE's cost-screening analysis. NIPPC takes no position, at this time, on what costs PSE actually defers, so long as PSE complies with CETA.

C. The Commission Should Be Proactive in Developing Principles for Use of Rate of Return on PPAs

PSE's Proposed RFP raises questions that the Commission needs to answer now. NIPPC believes it could be helpful for the Commission to begin considering other questions that could arise from CETA's provision encouraging use of a rate of return for utilities on PPAs. While it is not possible to conclusively resolve long-term policy questions regarding this new subject in the timeframe of this one RFP regarding only a single utility, additional Commission guidance will benefit all utilities, ratepayers, and IPPs who may wish to bid into PSE's Proposed RFP or any other future RFP.

One overarching principle that the Commission should recognize is that if the use of a return on a PPA is going to meaningfully impact utility actions, there must be some assurance at the time of the resource acquisition that the Commission will ultimately approve the return for use in rate recovery. Ideally, the utility would also be able to reasonably forecast with certainty the amount of the return at the time of the resource acquisition; NIPPC suggests Commission guidance that a return will be at least equal to the utility's *current* authorized rate of debt as of the time of each RFP. This would essentially establish a "floor" for the return for the life of the winning PPA, so long as that floor never exceeds the utility's authorized rate of return in violation of CETA. NIPPC understands the intent of the CETA provision at issue to be an encouragement of acquisition of PPAs and an attempt to limit the inherent utility bias to own generation resources. In the context of CETA, this encouragement makes sense because IPPs selling to a utility under a PPA are better suited and more likely to take on the risks of developing and taking on the risks associated with the newest cutting-edge technologies that will help the state's utilities achieve CETA's ambitious clean energy goals. However, if the utility has no certainty that it will in fact obtain a return on a PPA at the time of an RFP, the utility will remain fully incented to opt for a utility ownership bid or self-build option that would provide a guaranteed return to the utility's shareholders. Thus, NIPPC encourages the Commission to consider determining how it can provide the utility adequate assurance of the availability of the return on a PPA at the time of the acquisition.

Another principle the Commission should develop is how to determine which return to allow, if any, within the range of statutorily authorized returns. For example, the Commission may wish to consider the possibility of allowing a different rate of return depending on the RFP and depending on the resource. CETA recognizes that RFPs could be for "electric capacity, energy, capacity and energy, or conservation."[12] NIPPC queries whether the Commission thinks a higher return could be appropriate for a particular RFP or for certain categories of RFP (e.g., an RFP for capacity and energy versus an RFP for energy only). NIPPC encourages the Commission to recognize this as a possibility, and state it as such. Confirmation will provide certainty for utilities and may guide them in designing RFPs to be as "valuable" as possible. How the Commission values different RFPs is a significant question. At this time, NIPPC recommends that the Commission acknowledge the question and invite utilities and stakeholders to begin considering it.

Similarly, the Commission may wish to consider the possibility of allowing different returns depending on the winning PPA. One question already raised by other stakeholders is whether PSE should recognize that PPAs for long-lead time or unique resource types that the utility might otherwise be disinclined to commit to, but which could make meaningful contributions to achieving CETA's goals if successfully developed, such as pumped storage hydro.[13] Such resources may be deemed more valuable than PPAs for other resources and thus may warrant the additional

[12] CETA, 2019 c. 288 § 21(1).
[13] *See* Comments of Swan Lake and Goldendale at 3 (July 1, 2020).

encouragement of a higher return on the PPA (or tolling agreement) to encourage the utility to pursue the resource. In general, long-lead time resources tend to be disadvantaged in competitive bidding, unless their additional benefits are explicitly recognized. It may be appropriate for the Commission to incent utilities to prefer winning bids that offer additional benefits through providing a higher return. Again, NIPPC recommends that the Commission acknowledge this question and invite utilities and stakeholders to begin considering it.

III. CONCLUSION

NIPPC appreciates the opportunity to submit comments and looks forward to attending the July 30, 2020 Recessed Open Meeting on PSE's proposed RFPs.

Dated this 6th day of July 2020.

Respectfully submitted,

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