

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Amended
Petition of
PUGET SOUND ENERGY, INC.
For an Order Authorizing the Use
of the Proceeds from the Sale of
Renewable Energy Credits and
Carbon Financial Instruments

DOCKET NO. UE-070725

BRIEF OF PUBLIC COUNSEL

March 17, 2010

REDACTED VERSION

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I. INTRODUCTION

1. Puget Sound Energy, Inc.'s (PSE) Amended Petition requests approval of deferred accounting for the net proceeds of past and future sales of Renewable Energy Credits (RECs) and Carbon Financial Instruments (CFIs).¹ The Company proposes to use \$20 million of such proceeds to fund low-income energy efficiency measures and energy-related repairs, and renewable energy systems for low-income residences.² PSE also requests that it be allowed to retain \$21,062,800 to offset the balance it claims it is owed by California utilities from power sales during the 2000/2001 energy crisis (the "California Receivable").³ The Company proposes to return the remainder of REC and CFI sales proceeds to electric ratepayers.⁴
2. The Energy Project, Northwest Energy Coalition (NVEC), and Renewable Northwest Project (RNP) filed joint testimony supporting PSE's low-income energy efficiency and renewable projects proposals.⁵ However, these parties have not stated a position on the

¹ Amended Petition, ¶ 1.

² *Id.* at ¶ 13.

³ *Id.* at ¶ 19.

⁴ *Id.* The Company initially suggested that proceeds be returned by offsetting regulatory assets that are currently recovered through its base rates, but it has later stated that any of the various methods suggested by Staff, Public Counsel, or ICNU would be acceptable. *See DeBoer*, TR. 110:1-10

⁵ Public Counsel takes no position on the low-income energy efficiency and renewable systems proposals. *See* Exh. No. SN-1HCT, pp. 4:15 – 5:2 (Norwood Direct). However, Public Counsel provided the following recommendation:

[S]hould the Commission approve this proposal, such amounts [should] be derived from net REC proceeds collected after November 2009. . . . [A]ll other REC and CFI sale proceeds and any related energy sales margins collected later than November 2009, after any designated monthly allocation to low-income programs is made, [should] be immediately credited to all PSE retail customers through a non-general rate tariff, similar to the Company's Production Tax Credit (PTC) tracker mechanism.

Additionally, Public Counsel opposes the proposal by ICNU that any amounts allocated to low-income programs be deducted only from residential ratepayers' share of sales proceeds. This proposal should be rejected. All ratepayer classes currently fund low-income programs because the benefits of such programs extend beyond the residential class. *See, e.g.,* Puget Sound Energy Electric Tariff G, Schedules 120 (Electricity Conservation Service Rider) and 129 (Low Income Program). Moreover, residential ratepayers are entitled to the same level of sales proceeds as other classes regardless of whether the Commission allows a portion of these proceeds to be used for low-income programs.

Company's request to retain over \$21 million in sales proceeds to offset the California Receivable.⁶

3. Public Counsel has carefully reviewed PSE's proposals and recommends that all REC and CFI sales proceeds be returned to ratepayers. PSE has not demonstrated that the amount it seeks to retain would have otherwise been recoverable, nor has it demonstrated that the price the Company received for RECs sold to California utilities reflected a premium that could not have been obtained without settlement of the California Receivable litigation.⁷

4. It is undisputed that ratepayers will have paid the entire cost of developing the renewable resources from which RECs and CFIs are derived,⁸ and are therefore entitled to a full return of the proceeds. Thus, Public Counsel recommends that 100 percent of sales proceeds be returned to retail electric ratepayers with interest. In addition, any profits from the off-system energy sales made under the REC sales contracts with California utilities should be entirely returned to ratepayers.

II. BACKGROUND OF THE CALIFORNIA RECEIVABLE LITIGATION AND REC SALES

5. The facts of this case stretch back over the past decade and involve numerous parties, transactions, and proceedings, as well as various types of resources, assets, and markets. A brief overview of some of these facts follows.

6. RECs are tradable financial instruments that represent the right to claim environmental attributes or benefits associated with energy produced by renewable generation facilities.⁹

⁶ See Exh. No. J-1T (Joint Testimony of Eric E. Englert, Sandra M. Sieg, Danielle O. Dixon, Ann E. Gravatt, and Charles M. Eberdt).

⁷ See Exh. No. SN-1HCT, p. 17:13-21.

⁸ *Id.*

⁹ Amended Petition, ¶ 4.

Importantly, RECs can be used to demonstrate compliance with renewable portfolio standards.¹⁰

The majority of PSE's RECs are supplied from the Company's ratepayer-funded Wild Horse and Hopkins Ridge wind farms, and Klondike III Wind Power Purchase Agreement (PPA).¹¹

7. REC markets are relatively new and in an early stage of development. Markets in various states are presently defined by the laws and regulations of each state.¹² These laws and regulations in turn are "subject to ongoing pressures by affected parties seeking change to such laws and regulations."¹³ REC markets can be described as either "compliance" or "voluntary." Compliance markets exist in states with renewable portfolio standards where utilities are mandated to either use renewable generation or purchase RECs to meet such standards. Voluntary markets exist where parties are under no legal or regulatory obligations. Prices are significantly higher in compliance markets. Since 2007, PSE has sold RECs into both compliance and voluntary markets.¹⁴

8. PSE has received substantial proceeds from REC and CFI sales. From August 2007 through November 2009, PSE sold [Begin Highly Confidential] XXXXXXXX[End Highly Confidential] RECs, earning net proceeds of [Begin Highly Confidential] XXXXXXXX.¹⁵

¹⁰ Amended Petition, ¶ 8.

¹¹ See Exh. No. SN-1HCT, p. 8:8-10 (Norwood Direct). CFIs are related to PSE's participation in the Chicago Climate Exchange. Members of the Exchange pledged to reduce carbon emissions by one per cent annually. If members met that pledge, they were eligible to trade a commensurate quantity of CFIs banked in the year in which the reductions were achieved. See Amended Petition, ¶¶ 8-10. The CFIs referenced in this case were created as a result of PSE reducing the level of carbon emissions on its system from a baseline level established during the 1998 to 2001 period. The reduction in carbon emissions has been accomplished primarily by the Company's acquisition of renewable resources and by the acquisition of gas-fired, combined cycle generating resources that have low carbon emissions. See Exh. No. SN-1HCT, p. 8:10-15 (Norwood Direct).

¹² Amended Petition, ¶ 5.

¹³ *Id.*

¹⁴ DeBoer, TR. 151:20-24.

¹⁵ See Exh. No. SN-4HC, pp. 3-6.

be reflected in rates. Thus, the 2000 and 2001 sales had no bearing on PSE's regulated operations and PSE undertook them knowing that its shareholders would receive the full benefit of such sales. PSE then pursued the litigation to recover monies solely for shareholders. After on-going litigation both at FERC and in the courts, the parties recently reached a settlement that was linked to the sale of RECs. PSE's REC sales to SCE²⁰ and PG&E²¹ were approved by the California Public Utilities Commission (CPUC) in 2009. The California Receivable litigation settlement was also approved by the CPUC and FERC in 2009.²²

III. REC AND CFI PROCEEDS SHOULD BE RETURNED TO RATEPAYERS

11. The proceeds from PSE's sales of RECs and CFIs should be entirely returned to ratepayers.²³ Commission precedent and principles of equity support the full return of REC and CFI proceeds.

A. Ratepayers Fund the Generating Resources From Which RECs and CFIs are Supplied.

12. Because the Company is recovering the costs of the wind and other renewable generation resources from ratepayers, and will recover all prudently incurred future costs associated with operating these resources, it is ratepayers—not shareholders—who bear the risks and burdens of these resources. Accordingly, it is the ratepayers—not shareholders—who should receive the gain from the resource-generated assets.

¹⁹ Exh. No. TAD-1T, p. 6:3-10 (DeBoer Direct).

²⁰ *Id.* at 6:13-15.

²¹ Exh. No. DWS-14.

²² Exh. No. TAD-1T, p. 6:15-16 (DeBoer Direct).

²³ Mr. DeBoer alluded to this at hearing (TR. 133:14-22):

Q: Do you think it's reasonable for customers . . . to ask the Commission for a fair consideration the REC sales proceeds . . . to help defray the cost of the rate increase that Puget has requested?

A: I do. That's exactly why we filed the accounting petition and why we proposed to give the bulk of the REC revenues back to customers.

13. The Commission has repeatedly concluded that “the right to gain follows risk of loss and that the benefit of [a] sale should follow those who bore the burdens....”²⁴ Several courts and commissions have adopted this analysis.²⁵ Moreover, in *U.S. West v. WUTC*, the Washington Supreme Court held that a regulated utility *cannot fail to return to ratepayers the full value of “a lucrative ratepayer-funded asset.”*²⁶ In its decision, the Court reiterated that, since the lucrative operations at issue had been generated from ratepayer funds, ratepayers were entitled to return of the full value of the operations.²⁷ This principle is bolstered by the Commission’s requirements that companies obtain pre-approval for property sales.²⁸ The pre-approval process allows the Commission to determine whether the sale is in the public interest and whether the sale price reflects the full value of the assets being sold and will thus create the full benefit to regulated operations and ratepayers.²⁹

14. There is no dispute that PSE’s ratepayers pay all costs of the generating resources from which RECs and CFIs are derived. This includes the costs of the Hopkins Ridge and Wild Horse wind generation facilities, and the Klondike III PPA, from which a majority of PSE’s RECs are

²⁴ *In re the Matter of the Application of Avista Corp. for Authority to Sell its Interest in the Coal-Fired Centralia Power Plant, In re the Matter of the Application of PacifiCorp for an Order Approving the Sale of its Interest in (1) the Centralia Steam Electric Generating Plant, (2) the Rate Based Portion of the Centralia Coal Mine, and (3) Related Facilities; for a Determination of the Amount of and the Proper Rate Making Treatment of the Gain Associated with the Sale, and for an EWG Determination; In re the Matter of the Application of Puget Sound Energy for (1) Approval of the Proposed Sale of PSE’s Share of the Centralia Power Plant and Associated Transmission Facilities, and (2) Authorization to Amortize Gain over a Five-Year Period*, Docket Nos. UE-991255, UE-991262, and UE-991409, Second Suppl. Order, ¶ 47.

²⁵ *Id.* (citing *Democratic Central Comm. of the Dist. of Columbia v. Washington Metro. Area Transit Comm’n*, 458 F.2d 786 (D.C. Cir. 1973) and numerous state commission decisions).

²⁶ *US West, Inc. v. WUTC*, 134 Wn.2d 74, 96, 949 P.2d 1337 (1997) (emphasis added).

²⁷ *Id.* at 94-95.

²⁸ RCW 80.12.020. WAC 480-143-180 further specifies those assets not subject to pre-approval, but provides that under all such circumstances, Companies must seek pre-approval to sell any assets in excess of \$200,000 or one percent of the company’s rate base.

²⁹ See, e.g., *In the Matter of the Application of Verizon Northwest, Inc., For Order Regarding Transfer and Sale of Property*, Docket No. UT-071922, Order No. 01 (approving Verizon’s petition to sell properties only after Verizon demonstrated that it was receiving full value for the properties and that the sale would facilitate transfer to more efficient systems, add cash to regulated operations, and eliminate various operational costs).

derived.³⁰ Ratepayers have also paid all costs of the generating resource additions to PSE's system that has resulted in the creation of CFIs.³¹ The cost burden on ratepayers for these resources is substantial. The total annual revenue requirement for the Hopkins Ridge, Wild Horse, and Klondike III PPA paid by ratepayers is approximately [Begin Confidential] XXXX XXXX [End Confidential] per year.³²

B. Investors are Fully Compensated for the Risk of Their Capital Investment in Facilities that Supply RECs and CFIs.

15. In his Rebuttal Testimony, Mr. DeBoer asserts that the Company is entitled to retain a portion of REC sales proceeds because the capital costs of wind generation plants are provided "in the first instance by the providers of debt and equity capital."³³ However, Mr. DeBoer's assertion is flawed because it fails to recognize two important points.
16. First, as confirmed by Mr. DeBoer at hearing, "[t]he rates that [PSE has] in effect recover costs related to the wind facilities."³⁴ Indeed, the investment amounts for the plant are included in PSE's rate base and power supply calculations.³⁵ This includes approximately \$27.3 million per year in equity return to shareholders for the Hopkins Ridge and Wild Horse wind projects.³⁶ In addition, PSE's rates allow it an opportunity to recover its operating and maintenance costs, property taxes, income taxes, and depreciation associated with the plant.³⁷ PSE is also protected

³⁰ Exh. No. SN-1HCT, p. 9:1-9 (Norwood Direct). The Commission previously found all three of these acquisitions prudent. See *WUTC v. Puget Sound Energy, Inc.*, Docket No. UE-050870, Order No. 04; *WUTC v. Puget Sound Energy, Inc.*, Docket UE-060266 and UG-060267 (consolidated), Order No. 08; and, *WUTC v. Puget Sound Energy, Inc.*, Docket Nos. UE-072300 and UG-072301 (consolidated), Order No. 12 (hereinafter *2007 PSE GRC*).

³¹ Exh. No. SN-1HCT, p. 9:7-9 (Norwood Direct).

³² Ex. No. SN-6C.

³³ Exh. No. TDB-3HCT, p. 4:4-5 (DeBoer Rebuttal).

³⁴ DeBoer, TR 145:25 – 146:1.

³⁵ Exh. No. MPP-1HCT, p. 7:1-6 (Parvinen Direct).

³⁶ Exh. No. SN-7.

³⁷ Exh. No. MPP-1HCT, p. 7:1-6 (Parvinen Direct); DeBoer, TR. 146:4-9.

from operating risks because any prudent repair costs may be recovered through rates.³⁸ While there is no statutory definition of “operating expenses” in Washington, the Commission has the authority to review expenses and, “[i]f properly incurred, [expenses] must be allowed as part of the composition of rates.”³⁹ For instance, if the Company experiences damage to its wind farm equipment, the costs of repairing such damage would be recoverable through rates unless it was shown that they were imprudently incurred, as may be the case if the damage was caused by PSE’s own negligence.

17. Second, PSE’s investors and owners are *paid* for the risk of their investments.⁴⁰ The cost of the wind farms is included in the rate base upon which PSE is allowed the opportunity to earn a rate of return. Currently, PSE is allowed to earn 10.15 percent as its cost of equity, which results, when combined with its allowed cost of debt, in an overall rate of return of 8.25 percent.⁴¹ At hearing, Mr. DeBoer confirmed that the Company’s investors and owners are compensated through PSE’s rate of return:

Q: All of the risks inherent in the investment that investors make in PSE are reflected in the cost of capital they provide, correct?

A: Yes, I think that’s true.

Q: And in setting PSE’s rates, the Commission calculates that cost of capital and applies it to the rate base to determine the fair return component of rates, correct?

A: They provide an opportunity to earn that return, yes.

Q: And the fair return component of rates is how *investors are compensated for the risks* they undertake in providing their capital to PSE, correct?

A: Yes.⁴²

³⁸ See *People’s Org. for Wash. Energy Resources v. WUTC*, 104 Wn.2d 798, 810, 711 P.2d 319 (Wash. 1985) (stating, “[a] utility cannot include every expense it wishes in this operating expense category since the regulatory agency has the power to review operating expenses incurred by a utility and to disallow those which were not prudently incurred”) (hereinafter *POWER*).

³⁹ See *POWER*, 104 Wn.2d at 817 (quoting 1 A. Priest, *Public Utility Regulation* 49 (1969)).

⁴⁰ DeBoer, TR. 146:4-9 (confirming that PSE’s current revenue requirement includes a “reasonable return on shareholders’ investment in wind facilities).

⁴¹ 2007 PSE GRC, Order No. 12, ¶ 51.

⁴² DeBoer, TR. 112:13 – 113:1.

C. Precedent Supports the Return of REC and CFI Proceeds to Ratepayers.

18. In 2000, the Commission issued an accounting order requiring PSE to credit sales of excess sulfur dioxide (SO₂) emission allowances—similar to the CFIs in the current case—to its Other Regulatory Liabilities account, thereby passing proceeds from these sales to ratepayers through base rates.⁴³ The Commission previously required similar treatment for proceeds of SO₂ emission credit sales by PacifiCorp⁴⁴ and Washington Water Power.⁴⁵ Other state Commissions have similarly required 100 percent of proceeds from such sales to be returned to ratepayers. In approving a proposal by PacifiCorp in 2000, the Wyoming Commission stated, “in its brief... PacifiCorp argues that *all of the benefit from these sales would be returned to customers* under its proposal. We accept this argument and the company proposal.”⁴⁶

19. Recent treatment of the proceeds from REC sales in the Northwest reflect the precedent set in regulatory orders regarding proceeds from the sales of SO₂ emission credits. In the latest PacifiCorp general rate case, this Commission approved an all-party settlement that recognized an offset to PacifiCorp’s revenue requirement representing Washington-allocated REC sales proceeds.⁴⁷

⁴³ *Petition of Puget Sound Energy, Inc. for an Order Regarding the Authorization to Sell Sulfur Dioxide Emission Allowances and an Associated Accounting Order*, Docket No. UE-001157, Final Order, p. 2.

⁴⁴ *In the Matter of the Petition of PacifiCorp Seeking Blanket Authorization for the Sale of Surplus Sulfur Dioxide Emission Allowances*, Docket No. UE-940466, Commission Decision and Order Granting Authorization

⁴⁵ *In the Matter of the Petition of the Washington Water Power Company Seeking Blanket Authorization to Sell and Lease Sulfur Dioxide Emission Allowances and Seeking an Associated Accounting Order*, Docket No. UE-961156, Commission Decision and Order Granting Authorization.

⁴⁶ *In The Matter Of The Application Of PacifiCorp For Authority To Increase Their Electric Rates By \$12 Million Or 4.9%*, Docket No. 20000-ER-99-145, Commission Order, ¶ 202(b) (filed May 23, 2000), available at <http://psc.state.wy.us/htdocs/orders/20000-145-6579.htm> (last visited March 11, 2010) (emphasis added).

⁴⁷ In the most recent PacifiCorp general rate case, the Commission approved a settlement that acknowledged a revenue requirement reflecting well over \$.5 million test year REC revenues. See *WUTC v. Pacific Power & Light, d/b/a PacifiCorp*, Docket No. UE-090205, Final Order (Order No. 09), ¶ 38.

The Utah,⁴⁸ Wyoming,⁴⁹ and Idaho Commissions also require utilities to return the full benefit of REC sales to ratepayers. In 2009, the Idaho Commission ordered Idaho Power Company to sell RECs that the Company wished to retire or bank, and credit the proceeds to ratepayers. In its Order, the Idaho Commission accepted the Industrial Customers' argument that "the value associated with [RECs] *belongs to the ratepayers* and the only appropriate action is to sell the [RECs] and *credit ratepayers with the proceeds*."⁵⁰ The Commission then concluded that "the best use of the [RECs] at issue in this case is to sell them and use the proceeds to benefit Idaho Power ratepayers."⁵¹

20. This Commission has also required utilities to refund other similar types of revenues to ratepayers. For example, utilities are required to pass back to ratepayers production tax credits (PTC) they receive from the development of certain generation resources. This is done through a tracker mechanism that passes back credits which are based on megawatt hours of wind produced in each period. The PTC tracker mechanism returns 100 percent of the actual tax credits to ratepayers.⁵²

⁴⁸ See *In the Matter of the Application of Rocky Mountain Power for Authority to Increase its Retail Electric Utility Service Rates in Utah and for Approval of its Proposed Electric Service Schedules and Electric Service Regulations, Consisting of a General Rate Increase of Approximately \$161.2 Million Per Year, and for Approval of a New Large Load Surcharge*, Docket No. 07.035-93, Report and Order on Revenue Requirement, p. 91 (describing one party's dispute regarding REC proceeds: "UIEC argues the amount of revenue included in the test period from the expected sales of renewable energy credits . . . is too low"). Utah uses a future test year, so REC revenues are forecasted in rates. Thus, while parties disputed the method used to forecast revenues, there was no dispute that 100 percent of forecasted revenues were included in rates and credited to ratepayers.

⁴⁹ Exh. No. KCH-1T, p. 8:8-11 (Higgins Direct).

⁵⁰ *In the Matter of the Application of Idaho Power Company for Authority to Retire its Green Tags*, Case No. IPC-E-08-24, Order No. 30818, p. 2 (issued May 20, 2009), available at http://www.puc.idaho.gov/internet/cases/elec/IPC/IPCE0824/ordnotc/20090520RECONSIDERATION_ORDER_NO_30818.PDF (last visited March 11, 2010) (emphasis added).

⁵¹ *Id.* at p. 4.

⁵² See, e.g., PSE's Tariff G, Schedule 95A (Production Tax Credit Tracker).

D. Full Refund of REC and CFI Proceeds Will Help Mitigate the High Cost of Wind Generation Borne by Ratepayers.

21. Importantly, even if they receive 100 percent of REC and CFI sales proceeds as recommended by Public Counsel, PSE's ratepayers will likely still be paying significantly more for electricity than they would otherwise pay if PSE had purchased such energy from the market instead of building wind generation. For example, PSE's current projected cost of energy from Hopkins Ridge, Wild Horse, and the Klondike III PPA is approximately \$98 per MWh, which is roughly 115 percent *higher* than PSE's forecasted average market price of energy during this same period.⁵³ After REC and CFI proceeds are applied, the net cost paid by ratepayers for energy from these resources during the rate year ending March 30, 2011, would be approximately \$88 per MWh, which is still roughly 95 percent *higher* than PSE's forecasted average price of market energy purchases during the rate year.⁵⁴ The additional costs borne by ratepayers due to PSE's wind generation emphasizes the importance of returning all REC proceeds to these ratepayers.

IV. PSE'S PROPOSAL TO RETAIN REC PROCEEDS IS UNJUSTIFIED

A. Standard for Commission Review and Approval of PSE's Request to Retain REC Proceeds.

22. In proceedings before the Commission, the party coming forward—most often the company—bears the burden of proof. As noted by Staff at hearing, “the burden of proof is typically on the company to demonstrate that it’s operating in the best interests of customers.”⁵⁵ Petitions for accounting orders are governed by WAC 480-07-370(1)(b) and can, when they seek

⁵³ Exh. No. SN-1HCT, p. 10:12-13 (Norwood Direct).

⁵⁴ *Id.* at p. 10:17-19.

⁵⁵ Parvinen, TR. 204:8-14. The general burden of proof for administrative hearings is by a preponderance of the evidence. Am.Jur. Admin. Law § 357.

23. Here, PSE is not only seeking a determination of proper accounting treatment of REC and CFI sales proceeds, but also approval to retain a portion of the proceeds at issue based on claimed ratepayer benefits from REC sales allegedly linked to the settlement of the Company's California Receivable litigation. Thus, PSE “bear[s] the burden to prove that such recovery is proper” through “development of a detailed record.”⁵⁸

24. PSE's request to retain \$21 million of REC sales proceeds is based, in part, on the

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⁶⁵ See TAD-32, pp. 6-7.

29. Before SCE could consummate the REC purchase negotiated with PSE, it had to obtain approval for the sale from the CPUC. Accordingly, SCE filed an advice letter with the CPUC describing the sale and laying out its terms.⁶⁹ After the settlement, SCE filed a supplement to its advice letter, in which it stated:

As summarized by Commissioner Jones at hearing, SCE’s advice letter “doesn’t really say anything about the settlement other than the deal [it] made [with PSE] wasn’t *at all based upon the settlement*.”⁷¹

SCE provided the Commission with a confidential analysis of how SCE determined its bid price for the Puget auction and what the project's value is relative to its other 2008 offers. SCE's analysis demonstrates that the *Puget contract price is reasonable as compared to its 2008 shortlist*.⁷²

[REDACTED]

[REDACTED] [End Highly Confidential]

⁶⁹ Exh. No. DWS-7.

71 TR. 169:5-13.

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V. RATEMAKING TREATMENT AND CALCULATION OF REC AND CFI PROCEEDS AND RELATED MARGINS

36. PSE's calculations of net proceeds of REC and CFI sales should be reviewed for reasonableness. Interest should be paid on the unrefunded balance of net proceeds collected to date. Any margins realized from the energy component of PSE's bundled REC sales should also be returned to ratepayers in full. Both the net REC and CFI proceeds (with interest) and margins on energy sales should then be credited back to ratepayers in a manner similar to that applied to production tax credits.

A. Calculating Net Proceeds From REC and CFI Sales.

1. Expenses to be netted out of proceeds should be reviewed.

37. PSE proposes to deduct from the total REC and CFI sales revenues costs and credits associated with such sales or required to facilitate such sales. These costs may include:

[E]xpenses incurred in negotiating the transactions, finalizing the sales agreements and fulfilling the obligations under such agreements, including, but not limited to . . . attorney fees, broker commissions, royalty payments or other third party fees (such as WREGIS-related fees, the Center for Resource Solution fees and audit fees) and the net costs of the energy component of the transaction, if any.⁹¹

⁸⁸ See DeBoer, TR 178:11-13; Exh. No. TAD-14 (stating that all other sales were the product of bilateral negotiations or brokered deals).

⁸⁹ See RCW 19.285.040.

⁹⁰ DeBoer, TR. 179:4-6.

⁹¹ Amended Petition, ¶ 12.

These costs are not insubstantial. To date, PSE has recorded approximately **[Begin Highly Confidential] XXXXXX [End Highly Confidential]** in expenses associated with REC and CFI sales made prior to November, 2009.⁹²

38. There are two primary concerns regarding PSE's proposed calculation of net proceeds. First, the Company's definition of cost is too vague and could allow it to recover amounts that are "only peripherally related" to REC or CFI sales, or are already recovered through retail base rates.⁹³ As an example, PSE has not indicated whether internal labor costs, which are currently reflected in its base rates, would be included in its calculation of net proceeds.

39. Second, PSE proposes to include "net costs of the energy component of the transaction" in its calculation of net sales proceeds.⁹⁴ These costs represent any difference between the contract price for energy sold and the cost incurred in supplying the energy transaction.⁹⁵ However, there is *no apparent relationship* between the cost of energy sold and the contract price of RECs under PSE's sales agreements with the California utilities.⁹⁶ Therefore, it is unreasonable to adjust the net REC sales proceeds to reflect any such energy cost differences.

40. In light of these concerns, any costs reflected in PSE's REC and CFI sales proceeds calculations should be subject to review and reconciliation in future PSE general rate cases. In addition, the Commission should require PSE to file regular reports regarding REC sales, revenues, and costs, so that the Commission and interested parties can monitor the level of REC proceeds returned to ratepayers going forward.

⁹² Exh. No. SN-4HC. See also Exh. No. SN-1HCT, p. 19, Table 2 (Norwood Direct).

⁹³ Exh. No. SN-1HCT, p. 20:5-6 (Norwood Direct).

⁹⁴ Exh. No. SN-12.

⁹⁵ *Id.*

⁹⁶ Exh. No. SN-1HCT, p. 20:9-16 (Norwood Direct).

41.

B. Any Margins Realized From Off-System Energy Sales Under PSE's Bundled REC Sales Contracts Should Be Returned to Ratepayers.

42. A number of PSE's REC sales contracts are for bundled sales including both energy and RECs. Under these bundled sales contracts, the price of energy charged by PSE **[Begin Highly Confidential]**

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[End Highly Confidential]

43. It is important to note that PSE did not reflect the off-system energy sales associated with the REC sales agreements in the proposed baseline power cost forecast in the Company's pending general rate case.¹⁰⁴ As a result, any profits from these sales would flow to the Company and its investors, rather than to ratepayers who pay all non-fuel costs of the generating resources from which such energy would be supplied, unless the energy margins from these REC sales transactions are reflected in PSE's baseline power forecast or otherwise refunded to ratepayers.

Returning these profits is proper given that ratepayers have funded the generating resources from which they will be derived.¹⁰⁵ It is also consistent with this Commission's normal treatment of all such off-system sales.¹⁰⁶ In addition, PSE has acknowledged that

¹⁰² Exh. No. TAD-21HC.

¹⁰³ Exh. No. SN-1HCT, p. 16:8-19 (Norwood Direct).

¹⁰⁴ *Id.* at p. 19:6-8.

¹⁰⁵ See *supra* Section III.A.

¹⁰⁶ See Exh. No. SN-1HCT, p. 17:1-2 (Norwood Direct).

returning these proceeds to ratepayers [Begin Highly Confidential] XXXXX:


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C. Costs of Pursuing the California Receivable Litigation.

[illegible]

45. It appears that PSE has already collected from ratepayers the [Begin Highly
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XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX



¹⁰⁷ DeBoer, TR. 148:21 – 149:2.

¹⁰⁸ DeBoer, TR. 154:17 – 155:15.

¹⁰⁹ See *supra* Section II.

¹¹⁰ DeBoer, TR. 183:21-24.

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Public Counsel finds PSE’s recovery of these litigation costs troubling. Public Counsel understands that PSE’s prior rates have been approved by this Commission, but it is not clear at this point whether this aspect of PSE’s legal costs was reviewed in earlier proceedings. Moreover, given that the record of the current rate case is closed, there is not an opportunity to examine the issue in that docket.¹¹² Thus, a challenge to these costs would presumably require a complaint proceeding initiated by a party or upon the Commission’s own motion.¹¹³ The prospective recovery of these costs may also be a proper subject of scrutiny in subsequent rate proceedings.

D. Accumulated REC and CFI Sales Proceeds Should Be Immediately Credited to Ratepayers.

46. A portion of proceeds from REC and CFI sales should be immediately credited to ratepayers. As the Commission indicated in its order granting a motion to strike testimony

¹¹¹ DeBoer, TR. 184:1-19.

¹¹² *WUTC v. Puget Sound Energy, Inc.*, Docket No. UE-090704 and UG-090705 (consolidated).

¹¹³ The governing statutes and Commission’s rules allow for scrutiny of costs included in previously-approved rates, including potential returns to ratepayers of improperly recovered costs and penalties. *See* RCW 80.04.220, which provides:

When complaint has been made to the commission concerning the reasonableness of any rate, toll, rental or charge for any service performed by any public service company, and the same has been investigated by the commission, and the commission has determined that the public service company has charged an excessive or exorbitant amount for such service, and the commission has determined that any party complainant is entitled to an award of damages, the commission shall order that the public service company pay to the complainant the excess amount found to have been charged, whether such excess amount was charged and collected before or after the filing of said complaint, with interest from the date of the collection of said excess amount.

See also WAC 480-07-370(a) (governing formal complaints).

regarding such proceeds in PSE's current general rate case, it expected that any final determination in *this proceeding* could be effective simultaneously with, or shortly following, the conclusion of the general rate case.¹¹⁴ Moreover, PSE has acknowledged that it expects the Commission to order that REC proceeds be passed through to ratepayers immediately and that use of a non-general rate tariff could achieve this.¹¹⁵

47. As of November, 2009, PSE had accumulated approximately **[Begin Highly Confidential] XXXXXXXX [End Highly Confidential]** in proceeds from REC and CFI sales.¹¹⁶ Since these amounts have been realized, they should be immediately credited back to ratepayers with interest. As recommended by Public Counsel witness, Scott Norwood, this amount should be "applied to offset the approve rate base for PSE's Wild Horse and Hopkins Ridge wind generation facilities."¹¹⁷ To ensure that ratepayers receive this credit immediately, the adjustment should be reflected in the compliance filing for PSE's rates as approved in its pending general rate case.¹¹⁸

E. Future REC Proceeds Should Be Returned to Ratepayers Through a Tracker Mechanism.

48. The most appropriate method for returning future REC proceeds to ratepayers is through a mechanism similar to that used for production tax credits (PTC) arising from wind generation.¹¹⁹ Using a tracker mechanism is appropriate given the similarities between PTC and

¹¹⁴ See Order Granting Motion to Strike Testimony, Docket Nos. UE-090704 and UG-090705 (consolidated), ¶ 11. It is also noteworthy that PSE advocated for a very expedited schedule for this case, including only 15 days for hearing preparation and nine days for preparation of post-hearing briefs, on the grounds that ratepayers should begin receiving the benefits of REC and CFI sales proceeds as soon as possible. See Strom Carson, TR. 11:23 – 12:5 and 25:2-10.

¹¹⁵ Exh. No. SN-13.

¹¹⁶ See Exh. No. SN-4HC and Highly Confidential Errata Sheet to SN-1HCT (filed March 9, 2010).

¹¹⁷ Exh. No. SN-1HCT, p. 22:6-16 (Norwood Direct).

¹¹⁸ This is what PSE proposed in advocating for an expedited schedule in this docket. Strom Carson, TR. 12:2-5.

¹¹⁹ Exh. No. SN-1HCT, p. 23:1-9 (Norwood Direct).

REC proceeds. RECs, like PTCs, are valued based on the output of wind generation facilities, but are not fuel or energy related revenues.¹²⁰ Instead, they reflect the intrinsic value of the wind generation (or other renewable) resource. In addition, the values of both are contingent on laws and regulations.¹²¹ Whether or not the value of RECs (or PTCs) was considered in the PSE's economic studies in support of the decision to acquire or own wind resources, these values are derived from the asset and should be returned to ratepayers.

49. The REC tracker mechanism should be adjusted once every 12 months to reflect forecasted REC sales proceeds over the next 12-month cycle.¹²² This adjustment should also reflect any differences between the forecasted proceeds used in the design of the tracker mechanism during the previous 12-month period and the actual proceeds recovered during that same period.

50. Kroger has also proposed the use of a tracking account. However, Kroger proposed that proceeds be allocated “on a flat kilowatt-hour basis to all PSE retail generation customers.”¹²³ This allocation is not appropriate and should be rejected. Allocating proceeds on a flat kilowatt-hour basis could result in high-use ratepayers receiving proceeds in excess of their cost responsibility for the wind generation resources.

F. An Incentive for PSE to Maximize REC Sales Proceeds is Inappropriate for Current Sales and Unnecessary for Future Transactions.

51. At hearing, the idea of incenting PSE to pursue valuable REC sales was discussed. Specifically, it was suggested that, perhaps, PSE should be allowed to retain a portion of REC

¹²⁰ See TR. 180:2-5 (DeBoer testifying that the value of REC is “not related so much to weather like energy or season, it’s more related to RPS compliance in various states”). See also DeBoer, TR 181:3-15 (describing how the value of RECs in compliance markets are shaped by state laws and regulation).

¹²¹ See DeBoer, TR 181:3-15 (describing how the value of RECs in compliance markets are shaped by state laws and regulations).

¹²² Exh. No. SN-1HCT, p. 25:1-8 (Norwood Direct).

¹²³ Exh. No. KCH-1T, p. 10:19-22 (Higgins Direct).

proceeds even when such sales do not include a premium as the Company claims here.¹²⁴

Incentives are inapplicable to the sales at issue presently. Since these sales have already occurred and are finalized, creating an incentive is now moot. Moreover, absent the Amended Petition, these REC sales proceeds would have been passed back in full to ratepayers as a credit to the Company's "Other Electric Revenues" account.¹²⁵

52. In addition, incentives are not necessary for any future sales. It is likely that the amount of RECs PSE has available for sale going forward **[Begin Highly Confidential]** XXXXX
XXXXXX.¹²⁶ **[End Highly Confidential]** Furthermore, PSE has a legal obligation to provide least-cost service to ratepayers, which may include obtaining maximum value for excess RECs to offset what it must recover through rates.¹²⁷ Finally, the ratemaking process provides a built-in incentive for PSE to reduce its costs below those set by the Commission because PSE retains any cost savings.

53. If, however, the Commission chooses to develop an incentive mechanism for future sales, the Power Cost Adjustment Mechanism (PCA) offers a potential model. PSE's current PCA allows the Company to retain off-system energy sales (OSS) proceeds *in excess* of what are reasonably forecasted. This is appropriate here because, as confirmed at hearing by Staff, a company "should [not] be rewarded . . . for making a sale at market."¹²⁸ This was just the approach that the Idaho Commission took last year, when it ordered Idaho Power to record all

¹²⁴ DeBoer, TR.194: 7-25 and 195:1-4.

¹²⁵ Exh. No. TAD-28.

¹²⁶ See SN-4HC; DeBoer, TR. 179:4-6.

¹²⁷ See WAC 480-100-238 (governing integrated resource plans).

¹²⁸ Parvinen, TR. 204:12-14.

proceeds from the sale of RECs “in the Company’s 2010 Power Cost Adjustment (PCA) filing.”¹²⁹

VI. REVIEW AND REPORTING ON FUTURE SALES

54. The record in this case illustrates how uncertain the REC market is and raises questions regarding PSE’s REC sales practices. At hearing, Mr. DeBoer reiterated that the market is illiquid and that there is a lack of transparency in REC pricing and transactions.¹³⁰ In addition, Mr. DeBoer described PSE’s REC sales practices, noting that sales are made through individually brokered deals,¹³¹ meaning that there is little consistency or ability to oversee such transactions. Accordingly, the Commission, as well as other parties, would benefit from increased Commission oversight of PSE’s activities related to the sale of RECs. Oversight would allow the Commission and other parties to identify critical problems or issues.¹³² Such oversight would also help ensure that the substantial proceeds from such transactions are maximized for ratepayers who are funding the costs of the facilities from which RECs are supplied.

55. A settlement recently approved in PacifiCorp’s 2009 general rate case established terms for reporting and monitoring of REC sales activities on an ongoing basis.¹³³ The Commission should adopt similar requirements for PSE here. Despite PSE’s assertions to the contrary,¹³⁴ the bulk of the reporting requirements established in the PacifiCorp settlement are relevant to, and

¹²⁹ *In the Matter of the Application of Idaho Power Company for Authority to Retire Its Green Tags*, Case No. IPC-E-08-24, Order No. 30818, p. 1 (issued May 20, 2009).

¹³⁰ See DeBoer, TR. 126:17-21 and 142:1-6.

¹³¹ DeBoer, TR. 178:7-13. See also Exh. No. TAD-14.

¹³² In his Rebuttal Testimony, Mr. DeBoer asserts that reporting is unnecessary because Public Counsel has not “articulate[d] any actual issues with PSE’s treatment of RECs.” See Exh. No. TAD-3HCT, p. 20:18-19. However, it is precisely the lack of information (and previous reporting) that prevents Public Counsel from articulating specific issues at this time.

¹³³ *WUTC v. PacifiCorp d/b/a Pacific Power & Light Company*, Docket No. UE-090205, Final Order Approving And Adopting Settlement Stipulation (Order No. 09), ¶¶ 37-42 (hereinafter *PacifiCorp GRC*).

¹³⁴ See Exh. No. TAD-3HCT, p. 21:10-15 (DeBoer Rebuttal).

appropriate for PSE.¹³⁵ The relevant reporting requirements include: (1) an explanation of how the Company determines proper disposition of RECs; (2) a detailed accounting of RECs sold versus retained; (3) monthly REC generation by resource; (4) actual level of REC transactions on a MWh basis; and, (5) the actual level of REC-related revenues.¹³⁶ These types of reports would provide valuable information regarding PSE's REC activities regardless of the fact that PSE is a single-state utility.

VII. CONCLUSION

56. PSE's ratepayers bear the entire cost of developing the renewable resources from which RECs and CFIs are derived, and are therefore entitled to a full return of the sales proceeds. PSE has failed to show that it is entitled to retain any portion of these proceeds. Thus, Public Counsel recommends that the Commission order PSE to return 100 percent of sales to ratepayers, including interest on the current balance. In addition, any profits from the off-system energy sales made under the REC sales contracts should be returned entirely to ratepayers. Finally,

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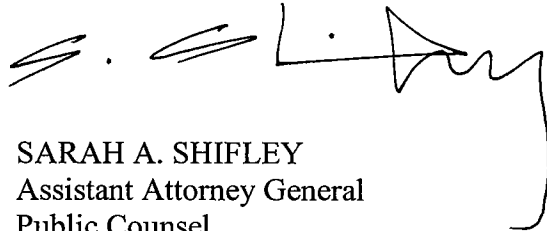
¹³⁵ Any reporting related to multi-state allocations would be irrelevant for PSE and thus need not be included.

¹³⁶ *PacifiCorp GRC*, Settlement Stipulation, ¶¶ 20-21 and Appendix C.

Public Counsel recommends that the Commission require PSE to file regular reports regarding REC generation and disposition.

DATED this 17th day of March, 2010.

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