PUGET SOUND ENERGY

Puget Sound Energy
P.O. Box 97034
Bellevue, WA 98009-9734
PSE.com

Received
Records Management
01/17/19 16:35
State Of WASH.
UTIL. AND TRANSP.
COMMISSION

January 17, 2019

Filed Via Web Portal

Mark L. Johnson, Executive Director and Secretary
Washington Utilities and Transportation Commission
P.O. Box 47250
1300 S. Evergreen Park Drive S.W.
Olympia, Washington 98504-7250

Re: Docket U-180907: Comments of Puget Sound Energy in Response to Notice of Opportunity to Submit Written Comments on adequacy of the current regulatory framework employed by the Commission in addressing developing industry trends, new technologies, and public policy affecting the utility sector

Dear Mr. Johnson:

Puget Sound Energy ("PSE") appreciates the opportunity to submit the following comments identifying and prioritizing the problem statements and principles important to PSE in addressing current and potential future regulatory frameworks at the Commission. PSE also provides comments on a few problem statements and principles raised by others during the workshop on December 10, 2018.

PSE perspective on problem statements

The utility industry is in a period of transformation driven largely by technological forces, public policy directives, and changing customer expectations. This transformation has resulted in a misalignment of the balance of customer interests and utility incentives developed in a prior era in which utilities sought to keep pace with growing customer demand for a reliable and affordable commodity service. Customer satisfaction is no longer just a question of reliability and cost. Customers now expect more control over their energy use and supply, with access to enhanced products and services. Navigating a successful transition to a regulatory framework that better aligns utility incentives with customer and public policy expectations will require collaboration from the Commission, utilities, and interested stakeholders on a range of issues.

Problem Statement #1: Utility incentives were aligned with customer and public policy expectations in previous eras, but are no longer aligned today

The traditional regulatory framework was originally designed, over a century ago, in an era requiring significant expansion of utility infrastructure. Utilities are incentivized to develop and expand the electric and natural gas systems to meet customer growth and their associated energy requirements. Yet, the conditions facing utilities have changed considerably. Traditional regulations and processes no longer provide PSE with the mechanisms to respond effectively to these changes nor the financial incentives to create an electric and gas system that meets the technological, public policy or premium service demands of the new era. In some cases, traditional regulatory practices hinder utilities from addressing the immediate challenges with urgency. PSE appreciates the Commission's attempts to address some of these challenges by approving limited alternatives to the strict traditional framework. Later in this document, PSE will discuss principles to consider in creating a new regulatory paradigm to address its problem statements.

1. Customers demand more choice, control and premium services, however traditional regulatory framework impedes PSE's ability to offer a full range of solutions

The traditional regulatory paradigm must be reformed to recognize the internal and external forces that are currently challenging the traditional operating model for electric utilities. The baseload, centralized and single directional grid design is quickly transitioning to a more intermittent, distributed and interactive model enhanced by two-way flows of electricity and data. The economically dispatchable generation mix is shifting from high carbon, coal-dominated supply to a low or no carbon mix where natural gas, distributed and renewable sources, and storage products are ascendant. Many customers are no longer interested solely in a reliable and low-cost commodity (i.e., electricity) and are becoming increasingly sophisticated with regard to their supply preferences and energy needs.

To that end, the regulatory paradigm must similarly evolve to allow utilities to provide more differentiated products and services to meet these increasingly varied customer interests. For example, customers increasingly desire choice in areas such as self-generation, alternative rate plans, behind-the-meter options, energy services, smart/connected home/office solutions, lighting solutions, community solar, and battery storage. PSE has responded to these customer needs with investments in metering technology through the Advanced Meter Infrastructure (AMI) initiative, transformative digital service options through the "Get to Zero" program, increased renewable energy offers through the Green Direct and Solar Choice programs, and new electric transportation options through an electric vehicle charging pilot program.[1] However, while PSE has implemented these new pilots and programs, our ability to scale these programs and make significant changes in our offerings for customers is constrained due to multiple factors in the traditional regulatory structure.

2. Utilities are at risk of being left behind implementing and adopting innovative technologies, non-wires solutions, and other programs customers want

At the same time that utilities must meet the increasingly varied needs and desires of their customers, they must continue to attract investments to provide essential energy security/resiliency and adopt new technologies to meet customer expectations and policy directives. These investment needs require a different investment profile than previous eras. Whereas the traditional regulatory paradigm works well to incentivize investments in large, long-lived projects (e.g., centralized generation assets and infrastructure to deliver generation to load), it does not work as well to meet the current investment needs of utilities that are more heavily-weighted toward small, dispersed, and shorter-lived projects (e.g., storage projects, vehicle charging infrastructure, and increasing information technology requirements).

[1] These investments are also responsive to public policy objectives for new technology, cleaner energy supplies, and others.

The traditional regulatory paradigm that emphasizes rates based on historic utility costs increases financial risks to utilities by inhibiting them from recovering costs in a timely manner, particularly given the increasing need of utilities to invest in newer technologies with useful lives much shorter than traditional assets. Smaller, shorter-lived investments do not benefit from existing flexible mechanisms (e.g., deferral accounting under RCW 80.80) and are more susceptible to the negative effects of regulatory lag. Regulatory lag in Washington can be as long as 27 months. For an investment in an asset with a useful life of 25 years, regulatory lag of 27 months could result in a utility not recovering 9% of depreciation expense associated with that asset. In contrast, for an investment in an asset with a useful life of 5 years, regulatory lag of 27 months could result in a utility not recovering 45% of depreciation expense associated with that asset. Utility investments that result in nearly half of depreciation expense unrecovered is unsustainable, and the regulatory model should be reformed to mitigate the effects of regulatory lag on investments in smaller, shorter-lived assets.

Additionally, the least-cost prudency standard assumes a customer paradigm in which customers are solely interested in a reliable and undifferentiated commodity (i.e., electricity) at the lowest cost and fails to acknowledge the fact that some customers desire premium products and services that do not fit well within the least-cost prudency standard. This model introduces uncertainty and risk to a utility that lacks the confidence that it will receive cost recovery for an investment in an innovative and promising technology or service that has not been subject to prior regulatory scrutiny. This lack of certainty can have the effect of incentivizing investments of limited capital in traditional utility infrastructure that has a greater likelihood of regulatory receptivity due to familiarity.

Problem Statement #2: Commission's authority and actions to address utility transformation and regulatory reform send mixed signals

Although the Commission has historically allowed utilities to operate under a few alternative regulatory mechanisms (e.g., multi-year plans, decoupling, expedited rate filings) to meet utility needs, these mechanisms have traditionally been approved on a case-by-case basis that may vary among utilities and have limited, sometimes changing, guidance on application. In light of recent activities, legislation is necessary to clarify the authority of the Commission to use alternative forms of regulation to meet the public interest.

For example, Commission Staff proposed an expedited rate filing methodology in Dockets UE-111048 and UG-111049 that would allow PSE to update its delivery services costs consistent with such methodology. PSE's first use of the expedited rate filing mechanism in Dockets UE-130137 and UG-130138 was subject to appeal, and PSE withdrew its expedited rate filing in Dockets UE-180532 and UG-180533 after Commission Staff informed PSE that it intended to move for dismissal of the proceedings, in part, due to a disagreement with PSE over the threshold burden associated with filing such a mechanism. To date, no rule exists that provides PSE with any certainty regarding the procedure or substance of expedited rate filing, thereby reducing the potential utility of such a mechanism.

To complicate matters, the opinion of the Washington State Court of Appeals in *Washington State Attorney General's Office, Public Counsel Unit v. Washington Utilities & Transportation Commission and Avista Corporation*[2] has cast uncertainty regarding the ability of the Commission to exercise its authority in any alternative form of regulation that deviates in any manner from the use of the traditional

[2] COA No. 48982 -1 – II.

regulatory methodology that uses a "modified historical test year" in a general rate proceeding. Absent any legislative relief, this opinion could exacerbate the problems with regulatory lag with respect to investments in assets.

1. **Uncertainty over regulatory mechanisms and appropriate regulatory lag have had a material impact on the financial outlook of PSE's parent company, and are primary drivers for financial markets recently downgrading the utility regulatory environment in Washington state to negative**

Regulatory uncertainty and inaction in the face of the transformations in the industry have had a recent and material impact on the financial outlook of PSE's parent company, Puget Energy (PE), when credit ratings agencies reduced PE's rating outlook from "stable" to "negative." In December 2018, S&P Global Ratings specifically called out Washington's regulatory environment as "less constructive compared to other jurisdictions, in part reflecting the lack of consistency in the regulatory construct in the state." Please see Attachment A to these comments for a copy of the S&P Global Ratings report. PE's negative rating outlook reduces investor confidence in Washington's regulatory framework and redirects low-cost capital to other jurisdictions that have embraced regulatory reform, thereby potentially increasing borrowing costs to the utility and costs to customers.

PSE perspective on principles for pursuing flexible regulatory mechanisms

In examining alternative flexible regulatory mechanisms, the Commission should emphasize the need to align customer interests, policy objectives, and utility incentives. As part of that alignment, the Commission should create clear, transparent, and predictable guidance for timely recovery of costs and use of flexible regulatory mechanisms. The Commission should also:

- define "customer benefit" in a manner that is sufficiently flexible to consider the varied interests of customers;
- reduce risks and facilitate an efficient and collaborative regulatory process for utilities to make investments in programs and advanced infrastructure that produce customer benefits;
- develop flexible regulatory mechanisms and innovative rate structures that allow utilities to respond with urgency to customer needs and evolving industry trends;
- allow utilities to earn returns on investments other than rate base, thereby making utilities indifferent in owning assets or contracting for services and removing any real or perceived biases from the utility decision-making process;
- continue to ensure reliability, affordability, and equity among utility customers;
- improve transparency and predictability for stakeholders and financial markets; and
- align with state public policy objectives, particularly carbon reduction and other environmental goals, and other customer interests.

PSE perspective on problem statements raised by others

The workshop on December 10, 2018, reflected a general agreement among stakeholders that the traditional regulatory paradigm is strained and that alternative forms of regulation are necessary to align utility incentives with customer and public policy interests. PSE does not plan to address all problem statements voiced by all stakeholders but simply provides a few examples below to illustrate where PSE may agree or differ.

PSE would neither characterize customer choice in the same manner as the Northwest Independent Power Producer Coalition nor prioritize customer choice over other issues. Customer choice interests should focus on the increasing interests of customers in a variety of products and services that could be offered by utilities that differ from the historic "one size fits all" approach that assumes that customers are interested solely in a commodity at the lowest reasonable cost. This is not to suggest that utilities would not continue to offer basic, affordable, and reliable electricity service to all customers. Rather, there is an increasing desire among some utility customers to participate in value-added programs and services on a voluntary basis, and the Commission must have sufficient authority to allow utilities to meet the needs of these customers without sacrificing basic, affordable, and reliable electricity service to all customers. Allowing utilities to provide new retail offerings beyond basic service should allow utilities to meet all customer interest, whether those interests are in value-added services or low-cost basic service.

PSE agrees with both (i) suggestions by Climate Solutions, NW Energy Coalition, and Renewables Northwest that the traditional regulatory paradigm may not always align with state public policy and (ii) suggestions by the Alliance of Western Energy Consumers that the Commission should remain an economic regulator and not expand its scope. PSE does not believe these suggestions are mutually exclusive. The Commission can satisfy both purposes by incentivizing utilities to pursue innovative conservation and clean energy programs to empower customers to reduce usage, carbon, and costs.

PSE agrees with Climate Solutions that the traditional regulatory framework does not reward utility innovation and utility efforts to address changing customer preferences for cleaner energy and new technology. The Commission should continue to work with utilities and interested stakeholders in a collaborative fashion to develop programs to meet these needs. The traditional, adversarial adjudicative process is not conducive to the development of programs that are in the public interest, and the Commission, utilities, and interested stakeholders should seek to work together to create utility products and services that meet increasingly sophisticated customer needs and an evolving industry.

PSE perspective on principles raised by others

PSE agrees with stakeholders that suggest that basic utility service should always be reliable, universal, and affordable. These principles are fundamental and the starting point under both the traditional and any flexible regulatory framework. These principles do not require a "one size fits all" approach that restricts the ability of utilities to meet the needs of customers who want enhanced service, greater choice control, or other optional services or products.

PSE also agrees with Public Counsel that this exercise poses the question of "how much change is needed?" However, PSE disagrees with Public Counsel's characterization that only incremental change is necessary. Washington utilities may appear healthy today, but customer needs and the energy industry are evolving at a rapid rate. The Commission and utilities must have the flexibility to adapt along with this dynamic environment and not be tied to antiquated methodologies developed for another era.

Conclusions and recommendations

Aligning utility incentives, technological forces, public policy directives and changing customer expectations will require both short-term and long-term solutions. In the short-term, the Commission should support legislation to clarify its authority with respect to flexible regulatory mechanisms that the

Commission has previously allowed (e.g., multiyear rate plans, decoupling, expedited rate plans) in light of the recent opinion of the Washington Court of Appeals. Additionally, the Commission can work collaboratively with utilities and stakeholders to consider and clarify the use of alternative regulatory mechanism proposals that advance innovation, customer choice, and public policy objectives. This is the opportunity for the Commission to promote proactive transformation in Washington.

Longer-term, the Commission should address the alignment of utility incentives with the public interest and reward investments in innovative programs and advanced infrastructure that both customers, policymakers and utilities want. The table below provides PSE's perspective on necessary reform to meet the evolving industry and customer needs.

Required Regulatory Framework for Evolving Utility Industry

	Current Regulatory Framework	**Required Regulatory Framework for Evolving Industry**
Goals	• Focus on reliability, availability, safety and affordability of centralized power system	• Focus on existing regulatory objectives as well as specific outcomes defined by policymakers, customers, utilities and other stakeholders
Business Model / Cost Recovery Method	• Evaluation of cost expenditures and recovery of prudent costs • Capital expenditures earn a return on investment • Operational expenditures and services are pass-through	• Planned and integrated generation, transmission, distribution, and conservation investments. • Optimization and recovery of total expenditures • Return on investment earned on total funds invested (regardless of capital or operational expenditures) • Verification of planned implementation and recovery of prudent costs
Utility Incentives	• Utility incentivized to increase rate base and usage to increase revenues • Rates generally volumetric with some fixed charges	• Incentives based on invested capital, management of services, contracts and valued outcomes/performance • Removal of ownership bias, conserve vs consume obstacles
Planning horizon	• Reverse looking planning • Short-term, least-cost focus • Traditional long-term capital planning process with inherent regulatory lag	• Collaborative, forward looking multi-year planning (3-5 yrs. planning cycle, with multi-decade vision) • Balanced focus on short-term cost minimization and long-term objectives and value maximization

The Commission should use this process to provide a forum for the Commission, utilities, and interested stakeholders to define a vision of the utility products and services over both the short-term and in decades in the future. Through this process, the Commission, utilities, and interested stakeholders can work together and implement a regulatory framework to achieve that vision.

Thanks again for the opportunity to provide comments. Please contact Nate Hill at (425) 457-5524 or nate.hill@pse.com for additional information or questions regarding this filing. If you have any other questions, please contact me at (425) 456-2142.

Sincerely,

/s/ Jon Piliaris

Jon Piliaris
Director, Regulatory Affairs
Puget Sound Energy
PO Box 97034, EST-07W
Bellevue, WA 98009-9734
425-456-2142
Jon.Piliaris@pse.com

cc: Lisa Gafken, Public Counsel
Sheree Strom Carson, Perkins Coie

Attachment: Attachment A - S&P Global Ratings report