SERVICE DATE

APR - 1 1991

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, Complainant, v. PUGET SOUND POWER & LIGHT COMPANY, Respondent.	)	DOCKET NO. UE-901183-T
In the Matter of the Petition of PUGET SOUND POWER & LIGHT COMPANY for an Order Approving a Periodic Rate Adjustment Mechanism and Related Accounting	)	DOCKET NO. UE-901184-P THIRD SUPPLEMENTAL ORDER

PROCEEDINGS: On October 10, 1990, Puget Sound Power & Light Company (Puget or company) filed two cases. The first (Docket No. UE-901184-P) is a petition for approval of a periodic rate adjustment mechanism, including deferred accounting. The second filing (Docket No. UE-901183-T) is tariff revisions to implement the periodic rate adjustment mechanism for an initial nine month period. The effect of the tariff filing would be to increase revenue by approximately $19.2 million over the nine month period January 1 through September 30, 1991.

The Commission suspended the tariff revisions pending hearings on the justness and reasonableness of the filing. The two cases were consolidated for hearing by Commission order dated October 17, 1990.

HEARINGS: The Commission held hearings on November 19 and December 5-7, 1990, and February 11-15 and 19, 1991, in Olympia, Bellevue, and Bremerton. The hearings were held before Chairman Sharon L. Nelson, Commissioner Richard D. Casad, Commissioner A. J. Pardini, and Administrative Law Judge Alice L. Haenle of the Office of Administrative Hearings. The Commission gave proper notice to all interested parties.

APPEARANCES: Puget was represented by William S. Weaver and James M. Van Nostrand, attorneys, Bellevue. The staff of the Washington Utilities and Transportation Commission (Commission staff) was represented by Steven W. Smith, assistant attorney general, Olympia. The public was represented by Charles F. Adams, assistant attorney general, public counsel section, Seattle. Intervenor Bonneville Power Administration (BPA) was represented by Geoffrey M. Kronick, attorney, Portland, Oregon. Intervenor The Washington Water Power Company (WWP) was represented by David J. Meyer and R. Blair Strong, attorneys, Spokane. Intervenor Washington Industrial Committee for Fair Utility Rates (WICFUR) was represented by Grant E. Tanner and Peter J. Richardson, attorneys, Portland, Oregon. Intervenor Northwest Conservation Act Coalition (NCAC) was represented by Kevin Bell, policy director, and by Robert C. Olson, executive committee member, Seattle.

SUMMARY: The Commission adopts Puget's decoupling proposal, as modified on rebuttal, on an experimental basis. The proposal will be implemented October 1, 1991. The Commission accepts Commission staff's proposal to reduce the company's authorized rate of return to reflect a lower level of shareholder risk resulting from this order. The Commission rejects the company's tariff filing in Docket No. UE-901183-T.

I. SCOPE OF PROCEEDINGS

A. Procedural History

Puget is an investor-owned utility company which supplies electricity in a large portion of western Washington. Puget filed these two dockets in response to a Notice of Inquiry (NOI) issued by the Commission on May 9, 1990. (Docket No. UE-900385) Sections B and C of this order describe various aspects of the NOI and its goals.

These are two consolidated cases. The first is Puget's proposed periodic rate adjustment mechanism. (Docket No. UE-901184-P) The company's proposal would require later-period reconciliation of certain adjustments to revenue collected for electricity delivered. After an initial nine month accounting period, the rate adjustment mechanism thereafter would be based upon one year periods.

The second case results from the Commission's suspension of tariff revisions to implement the proposed periodic rate adjustment mechanism for the initial period. Puget filedtariffs in UE-901183-T requesting a revenue increase of $19.2 million for the initial nine month period of January 1 through September 30, 1991.

The Commission suspended the tariff revisions and consolidated the two matters for hearing in orders dated October 17, 1990.

The Commission held ten days of hearings. It heard testimony from members of the public at Olympia on February 15 and at Bremerton and Bellevue on February 19, 1991. Nineteen witnesses testified at those public hearings.

On December 12, 1990, PacifiCorp, d/b/a Pacific Power & Light Co., filed a late petition to intervene. PacifiCorp withdrew its petition by letter dated December 17, 1990. The petition should be dismissed.

The parties submitted briefs on March 5, 1991.

B. Notice of Inquiry

In recent years, the Commission has actively encouraged the state's investor-owned utilities to meet demands for service with a least cost resource mix including both generating resources and improvements in the efficient use of electricity. The Commission in 1987 adopted WAC 480-100-251 requiring the electric utilities it regulates to engage in least cost planning. In 1989 the Commission adopted Chapter 480-107 WAC, setting up a competitive bidding system for proposals to supply needed generation and demand-side resources.

On May 9, 1990, the Commission issued a Notice of Inquiry (NOI), Docket No. UE-900385. The NOI was entitled "Examining Whether There Are Regulatory Barriers to Least Cost Planning for Electric Utilities." In issuing the NOI, the Commission stressed the following 1988 policy statement from the National Association of Regulatory Utility Commissioners (NARUC):

> "Ratemaking practices should align utilities' pursuit of profits with least cost planning."

The Commission listed the following three goals for the NOI:

> (1) determining whether our regulatory structure adequately "align[s] utilities' pursuit of profits with least cost planning";
>
> (2) determining if and how our regulatory structure should recognize utilities' increasing reliance on generating resources that are not constructed by the regulated utilities; and,

> (3) complying with the Legislature's mandate [Chapter 2, Laws of 1990, House Bill 2198] that we consider policies "to improve the efficiency of energy" and "protect a company from a reduction of short-term earnings" due to such increased efficiency.

(Notice of Inquiry; Docket No. UE-900385; May 9, 1990; p. 2)

The Commission requested comment on four general objectives to be served by programs or mechanisms that encourage the goals of least cost planning. The four objectives are: (1) adjustment for changes in revenue and costs beyond a utility's control; (2) purchased power cost recovery; (3) conservation cost recovery; and, (4) incentives for least cost supply and demand-side acquisitions. The NOI gave examples of several possible types of mechanisms to address each of these four objectives, without limiting the discussion to those examples.

The Commission sought initial written comment from a wide variety of entities. Among the comments received was a letter jointly signed by Puget, Public Counsel, NCAC, and Natural Resources Defense Council (NRDC). (Ex. 19) That letter committed those groups to work together to develop a mechanism designed to meet the goals of the NOI. The Commission encouraged these groups to work with the Commission staff and others to determine whether a mechanism could be collaboratively designed.

The result of the collaborative effort was Puget's filing in these dockets. The filing is Puget's recommendation. It is not the recommendation of the other participants, although it contains some elements of compromise.

Puget's filing was intended to address the first three objectives of the NOI. Puget deferred a proposal on the fourth objective, that is, incentives for least cost supply-side and demand-side acquisitions, pending further discussions with the participants. Puget expects to make a proposal to the Commission in June 1991 that would satisfy the fourth objective of the NOI.

The Commission has been impressed, both with the quality of written comments and with the collaborative spirit of the many participants meeting to resolve the issues posited by the NOI. Although this collaboration did not result in a consensus proposal, the participants agreed in principle on a number of points. The Commission encourages the participants to continue their cooperative approach through the incentive phase of this process.

C. Standards for Evaluation of Proposals

The parties to this case presented three general types of proposals, which will be discussed separately below. The Commission generally will evaluate proposals according to criteria outlined in the NOI:

(1) it must be measurable;

(2) it must be reasonably simple to administer;

(3) it must be easily explained to utility customers; and,

(4) it must be an improvement, on balance, over the current method of regulation at the WUTC.

(Notice of Inquiry; Docket No. UE-900385; May 9, 1990)

The Commission also will determine how well each proposal meets the three specific goals listed in the NOI.

II. THREE GENERAL PROPOSALS

The parties' three general proposals are: the so-called decoupling mechanisms proposed by Puget, Public Counsel, and NCAC; the Commission staff's least cost planning tracker; and, WICFUR's proposal for tracking specific production and conservation costs. In addition to their primary proposals, parties recommended specific revisions to Puget's proposal which they urge the Commission to implement only if it chooses Puget's proposal as the most reasonable. The proposals and recommended modifications are described below.

A. Decoupling

1. Puget Proposal

Puget's proposal calls for a periodic rate adjustment mechanism, annually applied. The adjustment consists of two major components. First, all revenue requirements are allocated to one of two categories of costs: "resource" costs and "base" costs. Base costs are divided by the number of customers on Puget's system, providing an authorized revenue per customer. As the number of Puget's customers grows or shrinks, booked revenue would grow or shrink. Disparities between authorized and collected revenue would be reconciled in the annual periodic rate adjustment proceeding.

The purpose of the base cost adjustment mechanism is to remove the current incentive for the Company to sell additional

kwh -- an incentive which exists because a portion of the revenue from the sale of each kwh adds to the Company's earnings. Hence, the mechanism is termed a "decoupling" mechanism because it decouples revenue from sales levels.

The other component of the Company's proposal, the "resource" costs, are recovered in a manner intended to make the Company whole for certain types of expenses related to energy resource acquisition. Further details of the "resource" category will be discussed below.

The amounts to be considered in the periodic rate adjustment mechanism will be determined as of a "cut-off date," proposed to be in April of each year. (Ex. 3) The Company annually will file for rate adjustment in June, with rate changes effective October 1 of that year, concurrent with the effective date of winter seasonal rates.

The mechanism includes general rate filings no less often than every three years, barring unusual circumstances. Periodic rate adjustments will be made annually on October 1 between general rate cases.

The company on rebuttal agreed to structure tariffs as a surcharge on rates. The company also agreed to supply certain detailed cost data to the Bonneville Power Administration (BPA) to facilitate calculation of average system cost. Puget also agreed to file a general rate case every three years.

The Commission staff recommended five modifications to Puget's proposal if the Commission adopts the proposal. First, tie the recovery mechanism to a rate of return band proposed by staff. Second, allocate resources and costs on a "principled" and consistent basis. Third, correct errors in the company's conservation adjustment. Fourth, modify the simplified dispatch model. Fifth, compensate ratepayers if they are to assume the risk of hydrological (hydro) conditions.

2. Public Counsel Proposal

Public Counsel offered a mechanism combining decoupling with a revised power cost mechanism. The primary difference between the company's proposal and Public Counsel's proposal is the allocation between base and resource costs.

Public Counsel's resource recovery mechanism includes five principal elements: (1) functionalization of all resource-related costs into the category covered by the resource recovery mechanism at previous general rate case levels; (2) inclusion of new purchased power contracts and changes in existing contracts approved by the Commission; (3) inclusion of secondary power

costs at the rate approved in the last general rate case reconciled for actual kilowatt-hours purchased; (4) inclusion of net changes in conservation investments based on the most recent end-of-period balance; and, (5) no hydro adjustment.

B. Commission Staff Least Cost Planning Tracker

The Commission staff developed a generalized tracking rate adjustment to include new purchase and sale contracts and changes in fixed costs of existing power purchase and sales contracts. (T-42, pp. 8-13) The tracker would be determined periodically, with a forward-looking rate perspective. The tracker would make use of company results of operations filed under WAC 480-100-031.

Staff witness Ken Elgin described characteristics of the tracker. It would be linked to results of operations statements with an earnings test. Demand-side management investment and power purchase contracts would be included. It would be implemented on a prospective basis, with no deferred accounting. Loads would be adjusted for estimated effects of demand-side management programs to avoid lost revenue. The tracker would be placed into rates in a separate schedule on an equal cents per kilowatt-hour basis.

C. WICFUR Proposal for Tracking Specific Production Costs and Conservation Costs

WICFUR's proposal is a modification of the Energy Cost Adjustment Clause (ECAC) mechanism which the Commission terminated in 1990. WICFUR recommends including all Commission-approved fuel related expenses, purchased power costs, wheeling expense and nonfirm sales revenue. (T-73, p. 13) WICFUR recommends deferral and subsequent recovery of only 90% of the difference between forecasted and actual expenses. WICFUR intends the 90% recovery to act as an incentive for Puget to control costs and maximize nonfirm sales opportunities.

WICFUR also recommends Puget be required to file a general rate case every three years.

III. COMMISSION DISCUSSION OF GENERAL PROPOSALS

Of the three major approaches presented for consideration, the Commission chooses the revenue-per-customer decoupling mechanism. The Commission will discuss here the reasons for choosing this approach over the other two mechanisms. Details of how the mechanism will operate are set forth in subsequent sections of this order.

The general approach -- to decouple revenue from sales and to "recouple" revenue to customer growth -- was supported by Puget, Public Counsel, and intervenor NCAC, as well as several public witnesses.

Decoupling revenue from sales addresses two of the objectives set forth in the Notice of Inquiry. First, it insulates the company from fluctuations in earnings that would occur through variations in energy consumption that are beyond the company's control. Second, it removes one of the financial disincentives for acquisition of company-sponsored demand side resources -- that is, the revenue lost when conservation programs are implemented.

The Commission staff and WICFUR opposed the decoupling mechanism. The Commission staff gave three reasons for its opposition: the decoupling mechanism is overly broad (T-55, p. 4); it is premature to implement the mechanism before the incentive phase is complete [TR 696]; and, there are legal ramifications from its implementation. (T-38, p. 12) WICFUR agreed with Commission staff that the decoupling mechanism is overly broad. (T-72; T-73) WICFUR also specifically criticized the revenue-per-customer decoupling approach on the basis that there is not an adequate statistical correlation between growth in customers and growth in base costs. (T-72, p. 18)

The least cost planning tracker proposed by the Commission staff drew criticism from the company (T-106, p. 21), intervenor NCAC (NCAC brief, p. 4), and Public Counsel. (Public Counsel brief, p. 32) The company raised four criticisms. First, the tracker does not remove the incentive to sell additional kwh and creates additional perverse incentives. (T-106, p. 21) Second, it guarantees under-recovery of costs where costs are increasing. (Puget brief, p. 15) Third, it is not sufficiently well formed to be implemented at this time. Fourth, it does not meet the requirements of section 404(f) of the federal Clean Air Act Amendments of 1990 for eligibility for conservation emissions credits.

Public Counsel and intervenor NCAC generally agreed with these criticisms. (Public Counsel brief, p. 32; NCAC brief, p. 4)

WICFUR's proposal drew fire from the company, the Commission staff, Public Counsel, and NCAC. The company argued that implementation of WICFUR's modified ECAC would produce over-earnings. Further, the Commission staff and Public Counsel noted that WICFUR's proposal suffers from the same flaws as Puget's ECAC, which was abolished by the Commission in its order in Docket No. U-89-2688-T. It is not clear whether WICFUR itself

continues to support the modified ECAC proposal, since the proposal was explored minimally in WICFUR's post-hearing brief.

The Commission will address each of the criticisms of the decoupling proposal first. Commission staff and WICFUR both accurately note that the decoupling mechanism is broad: it not only insulates the company from deviations in sales caused by conservation efforts, but also from deviations in sales caused by other factors, for example, temperature and customer-initiated conservation. The Commission views this as a virtue, not a drawback, of the decoupling mechanism.

As the Commission indicated in its NOI and in numerous previous orders, the Commission has approved adjustment mechanisms that are "traceable to changing weather patterns" (Order; Docket No. U-81-41; December 19, 1988; p. 21), provided that the other two criteria for implementation of such an adjustment are met.

Unlike the California ERAM, the revenue-per-customer decoupling mechanism does not insulate the company from fluctuations in economic conditions, because a robust economy would create additional customers and, hence, additional revenue. Furthermore, the Commission believes that a mechanism that attempts to identify and correct only for sales reductions associated with company-sponsored conservation programs may be unduly difficult to implement and monitor. The company would have an incentive to artificially inflate estimates of sales reductions while actually achieving little conservation. (T-106, p. 23)

The Commission staff's second criticism of the decoupling proposal is that it is premature to implement the proposal at this time, before the incentive phase is complete. It is true that this mechanism is untested and may produce unforeseen adverse results. Therefore, the mechanism will be implemented on an experimental basis only, subject to thorough review following the three year trial period. Also for this reason, the Commission has adopted the staff's concept of a banded rate of return in the modified form suggested by the company.

The Commission subscribes to the maxim that "the perfect should not be the enemy of the good." The parties have had well over a year to develop the outlines of this mechanism and there are not likely to be significant improvements between now and June 1991. The Commission does, however, encourage the parties to continue to discuss possible improvements to this mechanism that could be implemented during the pendency of and following the expiration of the initial three year experimental period.

The Commission staff's third criticism is that the decoupling mechanism generates legal issues: (1) it constitutes retroactive ratemaking; (2) it makes impossible a finding that rates are "fair, just and reasonable"; and, (3) it presents difficulties to BPA in its determination of average system cost.

The decoupling mechanism does not involve retroactive ratemaking. It is similar to the prior ECAC mechanism in that it sets up a deferred account allowing a reconciliation of revenue and expenses that would be subject to hearing and review. For the reasons set forth in detail in the Sixth Supplemental Order in Docket No. U-81-41, the Commission rejects the argument.

The second argument, that decoupling makes impossible a determination whether rates are fair, just and reasonable, is likewise flawed. Even under the current system of ratemaking, costs and rates will diverge immediately following implementation of a rate change. The decoupling mechanism will not alter this basic feature of existing regulation. Thus, even in this experiment, the Commission will determine whether rates are "fair, just and reasonable."

The Commission staff's third concern, the BPA average system cost calculation, will be addressed in Section VIII of this order.

WICFUR criticizes the company's specific decoupling proposal, noting that there is little correlation between growth in customers and growth in costs. This argument does not convince the Commission to reject the decoupling proposal. It is not surprising that changes in costs bear little statistical correlation between either changes in kwh sales or changes in numbers of customers. Most changes in a utility's costs of doing business are "lumpy," so that on an individual basis there may be little relationship between additional utility costs and the addition of a single new customer. For example, the hiring of a new employee will cost several thousand dollars and would be out of proportion to the addition of a single new customer; however, it may be justified by the addition of a hundred new customers. The company performed the statistical analysis only in order to test whether, once decoupling revenue from sales is found to be beneficial for independent reasons, "recoupling" revenue to growth in customers is likely to produce acceptable earnings levels. However, because the Commission in part shares WICFUR's concerns, staff's proposal, as modified by the company on rebuttal, to implement a rate of return band as a check on unacceptable results of the decoupling mechanism will be adopted.

We will now turn to a discussion of the other two mechanisms. With respect to the Commission staff's least cost tracker, the Commission appreciates the Commission staff's

willingness to provide an alternative mechanism to evaluate. The least cost tracker appears to have been developed largely as an alternative to avoid what the Commission staff considers to be impermissible retroactive ratemaking. However, the Commission shares the view of Public Counsel, the company, and NCAC that the tracker described by Mr. Folsom would tend to produce incentives that are contrary to those the Commission is trying to achieve in this case. Mr. Elgin, Commission staff's policy witness, noted that the Commission staff's proposal provides an "incentive for the company to invest in conservation that is not effective and to maximize sales." (T-38, p. 12)

Further, the fact that the mechanism contains no provision for reconciliation means that regulatory lag would still exist to the extent that costs were to exceed or fall short of projections. This may provide an incentive for the company to minimize investment in conservation and other cost-effective resources.

Because the Commission does not agree with the Commission staff's position on retroactive ratemaking, it is not necessary to adopt a mechanism whose primary raison d'etre appears to be to avoid deferred accounting. Because the decoupling mechanism is being implemented for other reasons, this order does not address the company's arguments concerning eligibility for Clean Air Act emissions credits. The Commission finds that the company's proposal meets the "net income neutrality" requirement of the Act and will make such a conclusion of law in the implementing paragraphs of this order.

It is not necessary to address WICFUR's modified ECAC proposal in great detail. The proposal suffers from the same flaws the Commission identified in Docket No. U-89-2688-T and would not correct the regulatory disincentives identified in the NOI. WICFUR's proposal to allow recovery of 90% of the difference between actual and forecasted expenses might provide an incentive to the company to reduce costs. The Commission encourages the parties to consider this aspect of the proposal in the incentive phase of this process.

IV. ELEMENTS OF RESOURCE RECOVERY COMPONENT

As the Commission accepts the decoupling mechanism, it must establish which of the company's costs will be coupled with customer growth on the "base" side, which costs will be included on the "resource" side, and how resource costs will be recovered. The parties strongly disagreed with Puget's allocation of many costs between base cost and resource cost categories.

The Commission staff criticized Puget's classification as inconsistent. Commission staff witness Roland Martin

recommended that the following elements be classified as resource costs: Bonneville Exchange Power (BEP) ten-year amortization; Skagit/Hanford and Pebble Springs nuclear amortization expense; and, production depreciation expense and certain operating expenses that were established in the previous general rate case which are integral parts of items already included in resource costs. (T-55, pp. 7-8)

Public Counsel's witness Jim Lazar "functionalized" base costs and resource costs. He allocated all resource costs to the resource recovery mechanism. He classified as resource costs all of the costs BPA uses in computing Puget's average system cost, as well as return and taxes on power supply investment and amortization of nuclear plant investment. (T-68; Ex. 70) Public Counsel characterized Puget's allocation between base and resource costs as an "ad hoc mixture of costs calculated solely to produce certain bottom line results." (Public Counsel brief, p. 5)

Intervenor NCAC called Public Counsel's proposal the most "sensible," but did not express strong support for one proposal. (NCAC brief, p. 2)

Because the Commission is adopting the company's proposal on an experimental basis, the Commission also adopts the company's proposal for classification of costs between resource and base categories. The Commission agrees with the company that the designations "base" and "resource" are not dispositive of the types of costs to be included in each category. There are many possible ways to allocate costs among base and resource. The company's allocation is based on an identification of certain resource costs that may tend to fluctuate from year to year, plus certain resource costs that may be increasing at a faster rate than growth in customers. The company's model shows that this allocation is likely to produce earnings near the company's authorized rate of return.

Base costs will include all costs that are not included in resource costs. Included in base costs are production depreciation, BEP 10-year amortization, Pebble Springs and Skagit amortizations, and transmission costs excluding those included in Mr. Lauckhart's variable power supply costs.

Resource costs will include those items included in Mr. Lauckhart's calculation of resource costs in Exhibit 88, page 4. Specifically, resource costs will include variable power supply costs, production O&M expenses, production rate base, and conservation costs. These items will be included in the resource revenue requirement as discussed below.

DOCKET NOS. UE-901183-T and UE-901184-P

A. Conservation

All parties agreed that conservation costs included in the resource category. There are a numbe different ways of calculating conservation costs, how general issues must be addressed: the amount of cons be included; whether to allow a carrying charge on ne conservation; and, treatment of competitive bid costs or capital investments.

1. Amount of Conservation to be Included in Rates

The company on rebuttal[1] proposed a three-part treatment of conservation costs. First, it would include in rates a return on net conservation rate base calculated on an average of monthly averages basis, based on the investment in conservation identifiable and reviewable on a prescribed cut-off date. Second, conservation amortization would be based on conservation investment at the same cut-off date. Third, any additional conservation investment from that time to the end of the next accounting period would not be included in rates but would accumulate a carrying charge (Allowance for Funds Used to Conserve Energy, or AFUCE). In the following rate period, the company would place into rates the newly established conservation investment including the accumulated AFUCE. NCAC agreed with this approach. (T-78, p. 6)

Commission staff witness Mr. Nguyen proposed to include in rates the return on the end-of-period conservation investment and conservation expenses that are most recently available. Additions to or subtractions from investment would not be reflected until they produce the end-of-period balance for use in the next period, nor would AFUCE accumulate on increases in the investment during the following accounting period. (T-51, p. 8)[2]

Public Counsel proposed that conservation rate base and amortization be based on the most recent known level of

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[1] The company's position on rebuttal differs substantially from its original testimony. We will not discuss the company's original proposal, nor the parties' criticisms of the original approach.

[2] The Commission is describing here the Commission staff's alternative proposal to modify the company's decoupling mechanism. Since the Commission has rejected the Commission staff's least-cost planning tracker, we will not address the staff's proposed treatment of conservation investments in the tracker.

investment. Public Counsel did not propose to accumulate carrying costs for additions to conservation investment. (T-68, p. 27)[3] He proposed postponing consideration of additional costs (such as AFUCE) until the incentive phase.

The Commission will adopt the company's approach. There are several ways of accounting for conservation costs that would make the company whole. The advantage of the company's approach is that only actual expenditures for conservation would be included in rates. That would allow the Commission and the parties to review conservation expenditures for prudence prior to their inclusion in rates. At the same time, however, the company would be allowed to accrue AFUCE on new expenditures after the cut-off date, thus making the company and ratepayers exactly whole.

The Commission staff and Public Counsel criticisms of the company's proposal seem to be based on their understanding that the company proposes to include projected conservation investments in rates. The Commission does not understand the company's proposal that way. The implementing paragraphs of this order will therefore clarify the exact treatment of conservation that is being approved here, in order to avoid future misunderstandings.

2. Carrying Charge Rate

No party explicitly addressed the appropriate carrying charge for AFUCE to be accumulated following implementation of rates. Consistent with the current level of return on ratebased conservation (not including the 2% equity premium), the company is authorized to apply its net-of-tax return for its AFUCE, based on the authorized rate of return discussed in the following section of this order. The company's proposal to exclude the 2% equity premium is accepted, pending the outcome of the incentive phase of this process.

3. Treatment of Bid Conservation

Mr. Nguyen testified for the Commission staff that the company should expense rather than capitalize direct payments to successful conservation bidders under the company's all resource Request for Proposals, as well as the administrative and general costs of administering bid proposals. The Commission staff also argued that these administrative and general costs should not be adjusted in the periodic rate adjustment. (T-51, p. 7) The

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[3] On brief, Public Counsel appeared to agree with the Commission staff. (Public Counsel brief, p. 24)

company agrees to expense direct costs, but sought to capitalize administrative and general costs. [TR 1149-1150]

The Commission agrees with the Commission staff's position that both direct payments and the administrative and general costs should be expensed based upon the analogy to purchased power. Both categories of costs of obtaining conservation contracts should be included on an actual basis in the periodic adjustment.

B. Hydro

The Commission has consistently stated that it favors mechanisms that insulate the company from the noncontrollable effects of fluctuations in hydro conditions, provided that three conditions are met:

> First, a power cost adjustment clause should be linked to those factors which are weather-related ...
>
> Second, ... a power cost adjustment clause should be a short-run accounting procedure that reflects the short-run cost changes affected by unusual weather ...
>
> Third, ... ratepayers should receive the benefit of a cost of capital reduction if the Commission approves a PCA for a company.

(Washington Water Power Company; First Supplemental Order Denying Petition; Docket No. U-88-2363-P; p. 8)

The parties concur that the company's proposed hydro adjustment mechanism satisfies the first two criteria. The mechanism is simple, easy to understand, and is clearly tied to weather-related conditions. However, except for the company, the parties also concur that the proposed mechanism does not satisfy the third criterion, that is, the company proposes no concomitant cost of capital reduction with the implementation of the mechanism.

The company's position on cost of capital is twofold; it first argues that in Docket No. U-89-2688-T the Commission adopted a cost of capital that in effect assumed the existence of a hydro adjustment. The reasoning is based on the fact that the cost of capital the Commission authorized is the same as the number advanced by the Commission staff's witness, who assumed the existence of a hydro adjustment. (Puget brief, p. 32)

This argument is without merit. The Commission in fact abolished the company's hydro adjustment in Docket No. U-89-2688-

T, and therefore the cost of capital authorized in that docket a priori excludes the hydro adjustment.

The second position advanced by the company is a proposal to implement the hydro adjustment now, with a promise to reexamine the cost of capital issue in the next periodic rate adjustment filing. (T-79, p. 19) The Commission has reservations about the company's offer. One of the criteria set forth in Docket No. U-89-2688-T for an interim cost adjustment proceeding is that such a proceeding be relatively non-controversial. (Third Supplemental Order; Docket No. U-89-2688-T; p. 15) If cost of capital became an issue in each periodic rate adjustment proceeding, the element of simplicity and ease of administration would largely disappear. The Commission would prefer, in general, to examine cost of capital issues in the context of a general rate case.

The Commission staff opposed the hydro adjustment unless there is a cost of capital reduction. Consistent with that position, it proposed removing the company's hydro adjustment. (T-60; Ex. 61) The Commission staff suggested in the alternative that, if the hydro adjustment is implemented, the Commission should reduce the authorized rate of return to reflect a hypothetical capital structure that increases the debt portion of the company's cost of capital and thus effects a reduction in ratepayer-supported risk. (T-40, p. 13; Ex. 41)

Public Counsel urged the Commission not to adopt a hydro adjustment at this time, but recommended re-examining the hydro risk issue in the incentive phase of this process. However, Public Counsel offers two possible mechanisms that he would prefer over the company's proposal. One would operate similar to the company's proposal, but would include only 80% of the difference between normal and actual flows. The second proposal would be essentially the same as Public Counsel's surcharge proposal in Docket No. U-89-2688-T.

Intervenor NCAC also opposed any hydro adjustment at this time. NCAC proposed to tie a hydro adjustment to the incentive phase of this process. NCAC noted that, because hydro conditions have been good in the past year, the company would not be harmed by postponing the adjustment's implementation and, in fact, the company might benefit from a postponement. NCAC also suggested postponement would further motivate the company to participate actively in the incentive phase. NCAC agreed with Puget's witness, Mr. Moskovitz (T-13, p. 18), that it may be appropriate to transfer "the risk elements ... from areas where the company has no control over the outcome to areas where the company can aggressively seek to meet long term resource planning goals." (NCAC brief, p. 9)

The Commission finds merit in all parties' positions. The company has developed a mechanism that is laudable in its simplicity, its freedom from manipulability, and its dependence on items that are clearly weather-related. At the same time, it still fails to meet the cost of capital reduction criterion. The Commission staff has proposed an elegant, objective solution to the cost of capital dilemma that has considerable attractiveness. NCAC has made a convincing argument that the reduction in risk associated with hydro conditions could be better transferred to items over which the company does have control.

The Commission, accordingly, will adopt the company's hydro mechanism on the condition that the Commission staff's cost of capital structure is implemented simultaneously. The company in its June 1991 filing will calculate a revenue requirement based on expenses and ratebase found reasonable in Docket No. U-89-2688-T, but which includes an adjustment to the authorized rate of return on ratebase consistent with the Commission staff's proposal. However, the Commission urges the parties to consider NCAC's suggestion that the hydro risk be transferred to items over which the company has more control.

C. Elements Not Disputed Among the Parties

The parties agreed that new purchased power contracts and changes to existing purchased power contracts should be recovered as resource costs on the basis of projection of costs and reconciled actual costs in the periodic rate adjustment.

D. Other Elements

1. Variable Power Supply Costs

These costs will be measured in the manner proposed by the company, as depicted in Exhibits 88 and 99. First, the level established in the preceding general rate case will be identified (currently, Docket No. U-89-2688-T). Second, using the simplified dispatch model as summarized in Exhibit 99, the difference between the costs from the preceding general rate case (allowed) and current costs will be determined. The sum of these amounts will represent the total variable power supply costs to be recovered.

2. Production O&M Expenses

These costs will be measured on an annual basis as proposed by the company. The production O&M costs included in the preceding general rate case order, prior to the production factor adjustment, will represent the level to be included in the resource revenue requirement. The production factor is the factor that is applied to power supply costs and production

property costs to account for the difference in rate year loads versus test year loads. In Docket No. U-89-2688-T this factor was 93.6%, as depicted in Exhibit 99.

3. Production Rate Base

These costs will be measured on an annual basis as proposed by the company. As with production O&M, these costs will be based on the level included in the most recent general rate proceeding prior to the production factor adjustment.

V. BANDED RATE OF RETURN

In order to address concerns that the company proposal would result in over-earnings or under-earnings, the Commission staff recommended a 100-basis-point band around the company's authorized rate of return. The band would be symmetrical, with 50 basis points above and 50 basis points below the authorized return.

At the time the periodic rate adjustment mechanism is filed, the Commission would examine the company's "Commission basis" results of operations statement, filed pursuant to WAC 480-100-031. If the statement showed a return above the band, the surcharge otherwise indicated would be reduced or eliminated so as not to add to earnings above the top of the band. If the statement showed earnings below the band, any decrease in rates otherwise implemented would be limited to an amount that would bring the company to the bottom of the band. (T-42, pp. 2-3; T-60, pp. 11-12; Commission staff brief, p. 38)

Puget on rebuttal proposed a different type of rate of return band. It recommended a band based on actual earnings from utility operations, rather than "Commission basis" reports. The company's band proposal would provide for deferral and accumulation of over-earnings and under-earnings outside the band during any estimating period. The accumulated amounts would then be factored into the revenue requirement calculation. (T-79, pp. 13-15) The company characterized its proposal as less likely to lead to controversy at each proceeding than the Commission staff proposal.

Public Counsel recommended a cap of 50 basis points above Puget's authorized rate of return and no floor. Public Counsel cited declining cost of capital and the company's ability to file a general rate increase if return falls too low.

The Commission acknowledges the Commission staff concern that a safety net be provided for ratepayers and shareholders during the decoupling experiment.

All of the parties to this proceeding agree that the data provided by the company have not compiled from a traditional review of "known and measurable" costs, but instead have been generated by the company's formulaic "black box" and corporate modeling estimates. Indeed, it is the use of estimates rather than actual results, as well as the concept of decoupling revenue from sales that has made this proceeding so difficult.

There is no party to this proceeding who can forecast with any certainty the ultimate outcome of implementing the company proposal. There is no party to this proceeding who has submitted any evidence that even one kilowatt-hour will be saved under this plan. That is why the parties agree that the company's proposal should be implemented on an experimental basis. It is possible as noted by Mr. Moskovitz that "the chances of over-earning is incredibly small." This observation is made more likely given the Commission's adoption of the company's proposed hydro adjustment; this will eliminate fluctuations in earnings attributable to hydro conditions.

Because this is the first decoupling mechanism of its type to be implemented in the United States, and as great believers in the law of unintended results, the Commission finds that prudence demands a banded rate of return adjustment mechanism. The adjustment to the authorized rate of return proposed by the company, which would allow a spread of 50 basis points above and below the actual results of operations (including the deferrals resulting from application of the hydro adjustment and other resource cost adjustments), is a reasonable proposal that should be part of this order and the experiment -- at least until the company's next full rate case proceeding. The total annual revenue to be collected will be between $850-950 million. Over-collection or under-collection beyond this banded range raises questions of equity and fairness to ratepayers and equity and safety to shareholders and bondholders. Accordingly, to make the experiment complete, the banded rate of return adjustment, as proposed by the company, will be adopted as a reasonable safeguard for all parties.

The Commission shares the concern expressed by Commission staff that applying the band to actual results could provide an incentive for the company to increase spending on items not ordinarily approved in general rate case proceedings (so-called "below the line" expenditures). The Commission will carefully monitor expenditures during this experiment to ensure that the company does not take advantage of the band mechanism.

VI. TIMING

Two separate issues come under the category of timing. The first is the date any rate changes should actually take

effect. The second issue is whether the company should be authorized to defer or collect revenue from the effective date of this order through September 30, 1991, and, if so, how the amount of such revenue should be calculated.

A. Effective Date of Rate Change

In Section III, the Commission adopted the revenue-per-customer decoupling mechanism and power cost adjustment as proposed by the company. Since the first full accounting period will begin October 1, 1991, the parties disagreed about the date on which the Commission should implement the mechanism.

Puget requested immediate implementation of its mechanism. Mr. Sonstelie recommended on rebuttal that issues of rate design, risk, and alternative least cost trackers be considered in subsequent proceedings. (T-79, p. 3) He also proposed to delay actual rate changes until October 1, 1991, providing the company was allowed to defer costs between April and October 1. [TR 1018]

The Commission staff recommended the Commission wait until completion of the incentive process before adopting decoupling. (Commission staff brief, p. 56) The Commission staff suggested this approach would allow all issues to be considered together, and would also give Puget some motivation to negotiate.

Public Counsel recommended delay in implementation of any mechanism until October 1, 1991. He recommended the Commission at this time adopt the broad outline of the plan it prefers. Final implementation of the plan on October 1, 1991, would give the Commission the chance to review the results of the incentive phase of this process before completing final details of the plan. (Public Counsel brief, pp. 3, 10)

Intervenor NCAC recommended several elements be deferred until the incentive phase. NCAC grouped these as "risk-related" issues, including hydro and banded rate of return. (NCAC brief, p. 3)

The Commission will implement any rate changes resulting from this order on October 1, 1991. Based in part on decisions described elsewhere in this order, this schedule will allow the parties to resolve several outstanding issues during the incentive phase. As discussed below, the Commission has concluded the company will not be harmed financially by this six month delay.

B. Revenue Increase Request for Partial Year

Except for the initial period, the periodic rate adjustment mechanism would be approved to operate annually for twelve months from October through September. Current rates were designed to provide cost recovery over a 12 month period. The Commission must determine how to implement the mechanism for the initial period until October 1, 1991.

The company originally calculated the rate increase for the initial period after implementation of a mechanism to be $19.2 million, for January 1 through September 30, 1991. The calculation was made by taking 9/12ths of the annual revenue requirement, thereby "averaging" revenue equally throughout the year. On rebuttal the company revised its revenue requirement somewhat in response to suggestions by other parties. Based on the same 9/12ths allocation, the revised nine month revenue requirement was calculated in rebuttal Exhibit 88 to be $16.2 million. The company did not provide a detailed description of the rate and revenue impact of applying a similar "averaging" methodology to the six months now remaining between April 1 and October 1, 1991.

Commission staff witness Roland Martin recommended modifications to the company's method to "reshape" the allowed base costs and certain portions of the resource costs to reflect the pattern of revenue expected to be received by the company for the year October 1990 through September 1991. (T-55, pp. 9-17) The Commission staff's proposal is outlined in Exhibit 56 for the nine month period, and in Exhibit 58 for a six month period.

The Commission staff contended the company would over-collect revenue if the nine month initial period excluded the full 28% of revenue already collected during the final three months of 1990. As an alternative, the Commission staff suggested estimating periods running from April through March.

Public Counsel recommended postponement of the entire decoupling proposal until October 1, 1991, which would result in no rate increase and no revenue deferrals because there would be no interim accounting period. (T-68, p. 16, 56) As an alternative, Public Counsel recommended a pro rata share on annualized base costs in the first six month period, if decoupling were adopted.

Public Counsel opposed the company's calculation, contending it would result in serious over-recovery. Mr. Lazar noted that the company ordinarily would collect 27% of its yearly revenue in the three months October through December 1990. To allow the company to collect 75% of the same revenue requirement between January and the end of September 1991 would result in

collection of at least 102% of revenue requirement. (T-68, pp. 16-17) The collection of 50% of revenue requirement between April and the end of September would result in an even greater over-collection, since the company normally would make only 44% of its energy sales during that period. (T-68, p. 56) Mr. Larkin performed further calculations in T-45.

The Commission will reject the company's tariff filing. The Commission believes that the company's estimate of a $9.5 million increase may not reflect the actual revenue that would be collected under the company's "averaging" proposal. In estimating the impact of a partial year's implementation, the company did not provide a detailed description of its methodology. Simply taking 75% or 50% of a full year does not properly credit ratepayers with the revenue that they have provided the company in the colder months of the year.

The Commission notes the lower current cost of capital and the exceptionally good hydro conditions which the area is experiencing. Under traditional ratemaking, the company would have a good year. In the context of this experimental proposal, the company has not convinced the Commission that the tariff filing would result in rates that are fair, just and reasonable.

The calculations of Commission staff and Public Counsel raise the specter of many millions of dollars in over-collections. This is unacceptable to the Commission and is unnecessary in order to implement this experiment.

Accordingly, the Commission will not immediately grant the revenue deferrals sought by the company, with one exception. The deferrals authorized by this order will begin to accumulate on October 1, 1991, the date of the proposed first periodic rate adjustment. The exception which the Commission will authorize relates to new conservation expenditures. Consistent with Section IV of this order, the company will be authorized to accrue carrying costs on conservation expenditures made after the April 30, 1991 cut-off date established in the following paragraph.

No party has testified in support of a particular cut-off date for determination of the revenue requirement to be implemented in October 1991. The company's exhibit 3 only refers to "April." In order to provide certainty to the company and the parties to these proceedings, the Commission establishes an April 30, 1991 cut-off date. The company will use this date to determine its revenue requirement for October 1, 1991 implementation and as the date to begin accruing AFUCE on new conservation expenditures.

VII. RATE DESIGN/COST OF SERVICE

There are two distinct rate design issues in this proceeding. The first is the rate design of the periodic rate adjustment revenue. The second is the question whether rate design issues in general should be reviewed. Both issues will be addressed in this section of the order. In addition, parties have raised certain cost-of-service questions that are best addressed here.

1. Spread of Revenue Adjustment

The company proposed to allocate the base revenue adjustments on an equal percentage change per class. On the resource side, the company assigned 80% of resource costs to energy and 20% to capacity. The company assigned the resulting energy costs based on energy usage of each class as a percent of the system. Demand costs were assigned to customer classes based on the contribution of that class to peak on the twelve highest system peak hours. (T-13, p. 23)

Commission staff agreed with the company's proposal for purposes of this case, on an interim basis.[4]

Public Counsel argued that it is incorrect to allocate 20% of resource costs to capacity. Absent a specific finding of the Commission concerning the appropriate allocation, Public Counsel recommended either an adjustment on an equal cents per kilowatt-hour basis, or an allocation of the revenue to the classes (or portions of classes, in the case of residential customers) that most significantly under-contribute to costs. (T-68, p. 51) Public Counsel also argued that treating base revenue differently than resource revenue is unduly complicated. (T-68, p. 48)

WICFUR argued that, with respect to base costs, the adjustment should be made on the basis of the percentage of each class's contribution to base revenue, not to total revenue. WICFUR also argued that, absent specific findings from the Commission on contribution to peak, only a uniform percentage allocation would be justified. Alternatively, WICFUR recommended a 30% peak/70% energy split, consistent with its testimony in Docket No. U-89-2688-T.

For the purpose of the experiment that is being discussed today, the Commission accepts the company's proposal.

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[4] Since the Commission did not adopt the Commission staff's proposed least-cost tracker, we need not discuss the Commission staff's rate design proposal for the tracker.

This proposal appears to deviate the least from the existing allocation of costs. Consistent with its position in the NOI, the Commission will not engage in a review of rate design issues in this proceeding. A rate design that deviates as little as possible from current rate spread will better allow the Commission and other parties to monitor the success or failure of the experiment. The other issues raised by Public Counsel and WICFUR will be addressed below.

2. General Rate Design Issues

Virtually every party to this proceeding agrees that it is necessary to provide customers with appropriate price signals, in addition to providing the utility with regulatory signals that encourage least cost planning. Commission staff witness Ken Elgin asked the Commission to initiate a review of rate design to ensure that customers' behavior is not contrary to the goals of least cost planning. (T-38, p. 7) Public Counsel and WICFUR, as discussed above, also indicate that Commission guidance on cost allocation is necessary in order accurately to implement the periodic rate adjustments. NCAC stressed that rate design is "an extremely important issue." (T-78, p. 2)

The Commission agrees. Because the company (absent extraordinary circumstances) is not expected to file a general rate case until early 1993, there is an excellent opportunity to review rate spread, rate design and cost allocation issues. Accordingly, as a condition of implementation of the decoupling mechanism sought by the company, the company should be ordered to make a rate design filing no later than April 1992. The Commission staff and other parties are encouraged to work with the company in the meantime to ensure that the concerns of all parties are addressed in the filing and that the cost-of-service studies presented in the filing contain adequate information.

3. Cost-of-Service Issues

The Commission staff and Public Counsel suggested that, rather than calculating the authorized revenue per customer in the decoupling mechanism on a company-wide basis, it may be preferable to disaggregate the calculated revenue per customer by class. However, both parties noted the company's current cost-of-service study does not contain adequate information to determine which costs by customer class are in the base category and which are in the resource category. The Commission staff also noted that the lack of information on total company base costs and resource costs makes it difficult to determine what portion of revenue collected under the present tariff structure should be applied to base costs and what portion to resource costs. (Commission staff brief, p. 33)

Without determining whether disaggregation or averaging is more appropriate, the Commission will order the company to provide in its cost-of-service studies filed pursuant to the previous section information that would enable a determination of base and resource costs for each class. Meanwhile, as recommended by the Commission staff, the decoupling mechanism will be implemented on an average revenue per customer. The collection of revenue will be implemented as shown in Ex 103.

VIII. BONNEVILLE POWER ADMINISTRATION CONCERNS

BPA witness Michael Federovitch testified about specific problems the BPA could face in its average syste (ASC) reviews if decoupling were adopted. BPA needs a ce level of detailed cost data in order to perform the ASC r Although Mr. Federovitch clearly stated the BPA could not prejudge the outcome of an ASC review -- and Mr. Federovi could only make recommendations to BPA's Administrator -- provision of the information is likely to assist the BPA in its review.

BPA must be able to determine the level of increases which have occurred in certain costs. Only certain production and transmission costs are allowed in ASC. Overall cost increases must be fully disaggregated. All individual cost components must be fully documented and supported.

Mr. Federovitch urged the Commission to take the following actions:

(1) Formalize Puget's proposal to file a general rate case every three years.

(2) Specifically review and approve transmission plant and operating and maintenance (O & M) costs.

(3) Require Puget to provide to BPA the detailed cost data which BPA needs to conduct its ASC review. This information should be provided with each decoupled rate filing.

(T-65, p. 16)

BPA requested the supporting documentation be broken down to the level of individual FERC accounts for all base costs included in the rate filing. BPA requested both projected cost data for the upcoming rate period and actual cost data for the three most recent recorded years. Finally, BPA requested a reconciliation

of projected costs to the prior general rate case and to the most recent recorded data provided.

In its rebuttal testimony, Puget agreed to file a general rate case every three years (T-79, p. 15), while keeping open its option to file more frequently if conditions so require. Mr. Sonstelie indicated Puget found the BPA's suggestions acceptable. (T-79, pp. 9-10)

The Commission staff on brief recommended four elements designed to assist in the ASC calculation. First, the changes in rates from the level set in the prior general rate case due to the mechanism should be in a surcharge format. Second, the Commission should examine base and resource costs at least every three years through a general rate case. Third, as a reporting requirement, Puget should file ASC documentation in a format as suggested by the BPA in Mr. Federovitch's Exhibit 67. Fourth, Puget should further provide BPA with additional data necessary to perform BPA's ASC calculation as it relates to base and resource cost classification as other unforeseen items arise.

The Commission agrees that it is important that Puget provide to the BPA a sufficiently detailed breakdown of costs to allow the BPA to conduct its ASC review. The Commission will therefore include in its order the recommendations of the BPA and the Commission staff. The Commission expects Puget to fully cooperate in providing necessary information to the BPA.

IX. PUBLIC COMMENT

The Commission held hearings in Olympia, Bellevue, and Bremerton to hear public comment on Puget's proposal. Nineteen witnesses testified at the three hearings. Illustrative Exhibits 108, 109, and 110 contain statements and materials brought by witnesses at the three hearings. Illustrative Exhibit 111 contains letters and statements sent by persons who did not attend the public hearings.

Tom Trulove and Ted Bottiger, Washington members of the Northwest Power Planning Council, testified in general support of the proposal. Puget's decoupling mechanism achieves the Council's stated goal of linking power company profits to energy the utility saves, as well as energy the utility sells. The Council also supports positive incentives, which will be addressed during the next phase of this process. The Council considers conservation to be a highest priority resource. The Council encourages further cooperation among the parties. The Council made no comments about proposals of the other parties or about the merits of any rate increase request.

Ralph Cavanagh from the Natural Resources Defense Council supported decoupling, together with incentives. He recommended the Commission give the parties a deadline for completion of the incentive phase of this process, so that if a package were not produced by collaboration of the parties, the Commission would institute its own package. The overriding objective should be to have services delivered at the lowest economic and environmental cost. Mr. Cavanagh supported elimination of significant market barriers.

Rhys Roth represented No Sweat, a citizen action group concerned with the greenhouse effect. This group generally supported the need to develop a regulatory structure giving utilities a powerful incentive to pursue maximum end-use efficiency and to reward ratepayers for cooperating with this goal by allowing them to share in the benefits and savings. The group also requested the Commission carefully review any rate request to be sure it was warranted. The group had not studied the details of Puget's proposal, but supported the concept.

Several individual ratepayers and representatives of homeowner groups opposed any rate increase. The Pamona Grange and Crystal Grange in Kitsap County were concerned that annual adjustments would not permit consumers sufficient opportunity to comment. A representative from the Wye Lake Community Club in southwest Kitsap County stated that Puget's service and rates are less satisfactory than those of the Mason County PUD, which is located nearby. Several customers stated that rates are already too high. Many experienced frustration that rates continued to increase despite their individual efforts to conserve.

Tony Robinson, director of purchasing and auxiliary services for the Clover Park School District, expressed concern that his agency was seeing no return from amounts already spent on conservation. He supported incentives for conservation.

The Homeowners' Association of Mountain Aire Park is working with Puget to solve continuing outage problems. The Somerset Community Association has also experienced frequent outages. Puget has attempted to identify the cause of these outages but has yet to correct the problem.

Several customers expressed concern that the Puget proposal was difficult to understand.

The Commission appreciates the breadth of the comments delivered at the public hearings. The Commission urges Puget to develop a customer information program which as clearly as possible explains to customers the new mechanism.

X. GUIDANCE ON INCENTIVE PHASE

The Commission encourages the parties to participate fully in the next phase of this process, designed to develop positive incentives for least cost planning. Several examples are discussed in the NOI. The Commission offers the following general guidance regarding the incentive phase of this process.

The Commission encourages the parties to ensure that conservation programs are developed to benefit each class of customers. The Commission also encourages the development of mechanisms to measure conservation programs' performance.

The Commission considers both reward for positive behavior and disincentives for negative behavior to be integral parts of incentive programs.

In order to allow time for evaluation of any incentive program, the Commission must have the incentive proposal by June 15, 1991.

FINDINGS OF FACT

Having discussed above in detail both the oral and documentary evidence concerning all material matters, and having stated findings and conclusions, the Commission now makes the following summary of those facts. Those portions of the preceding detailed findings pertaining to the ultimate findings are incorporated herein by this reference.

1. The Washington Utilities and Transportation Commission is an agency of the state of Washington vested by statute with authority to regulate rates, rules, regulations, practices, accounts, securities, and transfers of public service companies, including electric companies.

2. Puget Sound Power & Light Company, respondent and petitioner herein, is engaged in the business of furnishing electric service within the state of Washington as a public service company.

3. On October 10, 1990, Puget filed a petition for approval of a periodic rate adjustment mechanism, including deferred accounting. The petition was given Docket No. UE-901184-P.

4. Also on October 10, 1990, P[illegible]t filed tariff revisions designed to implement the perio[illegible]rate adjustment mechanism for an initial nine month perio[illegible]The stated effect of the tariff revisions would be to increase [illegible]enue by approximately $19.2 million over the nine [illegible]nth period January 1

through September 30, 1991. The tariff revisions were given Docket No. UE-901183-T. The Commission suspended the tariff revisions by order dated October 17, 1990. The Commission ordered public hearings concerning the justness and reasonableness of the proposed revisions.

5. By order dated October 17, 1990, the Commission consolidated the two dockets for hearing and determination.

6. The company's proposal as revised on rebuttal is consistent with the goals of the NOI. Decoupling on a revenue-per-customer basis will assist in removing disincentives to least cost planning. The mechanism as modified on rebuttal should be adopted on an experimental basis. Because the experiment may produce results not fully foreseeable at this time, the program must be fully reviewed within three years.

7. The company's allocation between base and resource costs is accepted, including its proposed method for calculating resource costs as proposed on rebuttal.

8. Conservation costs will be recovered through their inclusion in resource costs on an actual basis. The cost of conservation shall include return on conservation rate base, amortization of conservation investment, amortization of deferred federal income tax, costs associated with purchased conservation, and tax benefits of current conservation expenditures.

Return on rate base for conservation will be based on the rate period average of monthly averages net balance of conservation. The net balance will include capitalized grants and other capitalized costs as of the April 30, 1991, cut-off date, accumulated amortization of these capitalized investments, deferred federal income tax, and the actual balances of outstanding conservation loans. The return rate to be used will be the net-of-tax overall return. As indicated earlier, the two percent equity premium will apply only to investment included in Docket No. U-89-2688-T.

Amortization of conservation investment will be based on conservation through the April 30, 1991, cut-off date. Costs associated with purchased conservation will include both the payments for conservation received and administrative costs of overseeing these purchase contracts.

9. The company's proposed hydro adjustment is accepted, provided the authorized cost of capital is reduced, as proposed by Commission staff, to reflect lower risk to shareholders.

10. Except for certain conservation costs as described in Finding of Fact No. 8, the decoupling mechanism should not be implemented before October 1, 1991. Decoupling for a partial year has not been supported.

11. Puget on rebuttal committed to filing a general rate case at least every three years. This commitment is a necessary condition to the Commission's approval of the mechanism.

12. A surcharge format is most appropriate for rates under the mechanism.

13. Puget committed on rebuttal to provide detailed information to the Bonneville Power Administration for purposes of BPA's average system cost (ASC) review. The company must provide the information specified by BPA's witness and the Commission staff's recommendations in this proceeding for ASC review.

14. The company's tariff filing is likely to result in a significant over-collection of revenue above its authorized level. The tariff filing would result in rates that are excessive. It should be rejected. In part because of good hydro conditions and lower costs of capital, the company will not be adversely affected by rejection of the tariff filing.

15. In order to evaluate properly any incentive proposals which will result from the next phase of this process, the proposals must be filed by June 15, 1991.

16. As a condition of approval of this experiment, the company must make a rate design filing by April 1992 for the Commission's review.

17. The company's next cost-of-service filing should include data sufficient to determine the base and resource costs for each of Puget's customer classes.

18. The company's proposal for a banded cost of capital is accepted. The company will be authorized to defer over and under recovery amounts necessary to bring its actual rate of return (taking into account deferrals and other resource cost adjustments established in this order) to within a band of 0.50% above and below the authorized rate of return established in the company's most recent rate case.

19. The cut-off date for the company to establish the revenue requirement to be implemented on October 1, 1991, and for the company to begin accruing AFUCE on new conservation investments is April 30, 1991.

20. PacifiCorp, d/b/a Pacific Power & Light Company, filed a late petition for intervention. The petition was withdrawn by letter dated December 17, 1990.

CONCLUSIONS OF LAW

1. The Washington Utilities and Transportation Commission has jurisdiction over the subject matter of these proceedings and the parties thereto.

2. The company's proposal as revised on rebuttal, and with the cost of capital reduction proposed by Commission staff, should be implemented on October 1, 1991, on an experimental basis, subject to full review within three years. The company should be authorized to accrue AFUCE on additions to conservation after the April 30, 1991 cut-off date.

3. The company should be ordered to provide information to BPA regarding ASC as detailed in the body of this order.

4. The tariff revisions under suspension in Docket No. UE-901183-T name rates and charges which are excessive and inappropriate. They should be rejected in their entirety.

5. The incentive proposals should be filed by June 15, 1991.

6. The rate design filing should be made by April 1992.

7. All motions made in the course of this hearing which are consistent with the findings and conclusions should be granted. Those inconsistent therewith should be denied.

8. The mechanism approved today meets the "net income neutrality" requirements of Section 404(f)(2)(B)(iv) of the 1990 amendments to the federal Clean Air Act.

On the basis of the foregoing analysis of evidence, findings, and conclusions, the Washington Utilities and Transportation Commission makes the following order.

ORDER

WHEREFORE THE COMMISSION HEREBY ORDERS:

1. The tariff revisions filed by Puget and now under suspension in Docket No. UE-901183-T are rejected.

2. The company's periodic rate adjustment mechanism as revised on rebuttal shall be implemented on October 1, 1991, on an experimental basis. It will be subject to review within three years. Tariffs filed under the mechanism will be made in a surcharge format.

3. The company is ordered to provide to BPA the information on ASC as discussed in the body of this order.

4. The company is ordered to make a general rate filing every three years while this mechanism is in effect, as a condition of approval of this mechanism.

5. An incentive filing is also a condition of the decoupling mechanism and should be filed no later than June 15, 1991.

6. The company shall make a rate design filing no later than April 1992.

7. The petition to intervene filed by Pacificorp is dismissed.

8. All motions consistent with this order are granted. Those inconsistent with this order are denied.

9. The Commission retains jurisdiction to effectuate the provisions of this order.

DATED at Olympia, Washington, and effective this day of April, 1991.

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

A. J. PARDINI, Commissioner

Sharon L. Nelson, Chairman (Concurring in part and dissenting in part) - I dissent from the majority's decision to approve a banded rate of return with this adjustment mechanism. I believe the band, which would defer profits and losses into

successive periods, is totally unnecessary to the main object of this proceeding. The company's proposal is not only unnecessary, it burdens this relatively straightforward adjustment mechanism with unnecessary and potentially troublesome baggage.

Our staff originally suggested a banded rate of return -- used only to defer or limit the application of adjustment formulas -- because of the staff's fear that the company's initial proposal could result in substantial over-earning. Company witness Moskovitz testified on rebuttal that the staff-proposed banded rate of return probably will be unnecessary because it would not be utilized. Public Counsel concurred with the staff, but suggested that an asymmetrical band, a cap with no floor, would be a preferable way to prevent substantial over-earning while providing incentives fostering efficiencies.

In my view, it is not necessary to throw out the beneficial aspects of traditional ratebase - rate of return regulation, including regulatory lag, and our more traditional remedies for treating over- or under-earning problems. Other elements of the adjustment mechanism eliminate most of the traditional sources of earnings' volatility. Fluctuations in weather, sales, and power costs are explicitly accommodated in this case. If the company were to over-earn continuously or at a level deemed "obscene," the Commission, having monitored the company's earnings reports, could file a complaint at any time. Likewise, if the company were to experience under-earning, it has explicitly retained the right to file a general rate case.

The majority opinion says the results of this experiment are uncertain. That is true. However, acceptance of major portions of the company's proposal has dramatically reduced the company's overall risk. Further insulation of the company's risk by adoption of the company's narrow banded rate of return, raises substantial questions about retroactive ratemaking and the specter, wholly unacceptable in my mind, of guaranteed financial performance. Indeed, adoption of the company's banded rate of return severely undermines the decoupling mechanism's incentives toward efficiency and cost cutting.

Finally, adoption of the banded rate of return negates one of the chief goals of the NOI, which was to replace the ECAC mechanism with a simple, easily explainable mechanism which ratepayers would readily accept. Deferring profits (and losses) from one estimating period to the next appears to be extremely difficult to implement and can turn what should be a routine review and adjustment into a major rate case. The banded rate of return adjustment, rather than making the experiment complete as the majority believes, may, if its use becomes necessary, cause

so much confusion and unnecessary litigation that we will never be able to judge the results of this otherwise worthwhile experiment.

I concur with the decision of the majority in all other respects, including approval of the staff's capital structure adjustment to the company's proposed hydro mechanism.

Sharon L. Nelson

SHARON L. NELSON, Chairman

Richard D. Casad, Commissioner (Concurring in part, dissenting in part) - I dissent from my colleagues' decision to implement the Commission staff's proposed adjustment to the company's authorized rate of return.

I appreciate the Commission staff's attempt to provide a reasoned basis for downward adjustments to the company's rate of return due to the shifting of risk of hydro conditions from shareholders to ratepayers. However, I do not believe at this time that the Commission staff has presented sufficient evidence to support its proposed cost of capital adjustment. In the company's last general rate case a number of eminent experts tried but failed to quantify the impact that the ECAC -- which included a hydro adjustment -- had on cost of capital. The Commission found in that case that "the ECAC's influence on Puget's cost of capital is too difficult to measure."

The mechanism that the Commission is approving today contains several changes to the current regulatory structure. Some of these reduce the company's risk, some may increase it. (T-106, p. 11) I do not believe that the parties have had an adequate opportunity to examine all of the implications of this mechanism in terms of risk, and am reluctant to accept the Commission staff's proposal at this time. I would accept the company's offer to review this issue in the context of hearings on the company's first periodic rate adjustment filing in June 1991.

Accordingly, I would accept the hydro mechanism as proposed by the company with no concomitant reduction in the company's authorized rate of return.

In all other respects, I concur with the decision of the majority.

Richard D. Casad, Commissioner

NOTICE TO PARTIES:

This is a final order of the Commission. In addition to judicial review, administrative relief may be available through a petition for reconsideration, filed within 10 days of the service of this order pursuant to RCW 34.05.470 and WAC 480-09-810, or a petition for rehearing pursuant to RCW 80.04.200 or RCW 81.04.200 and WAC 480-09-820(1).