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Filed Via Web Portal

Mark L. Johnson, Executive Director and Secretary
Washington Utilities and Transportation Commission
621 Woodland Square Loop SE
Lacey, WA 98503

Re: Docket UE-191023: Comments of Puget Sound Energy as Follow-Up to the March 17 Incremental Cost of Compliance Workshop

Dear Mr. Johnson:

Puget Sound Energy (“PSE”) offers the comments below as follow-up to the incremental cost of compliance workshop on March 17, 2020. Specifically, PSE would like to provide: (1) some context regarding how PSE believes the two percent threshold should be interpreted and applied; and (2) more detailed comments in response to the five discussion questions raised at the workshop.

PSE worked closely with both legislators and the Commission in consideration of the rate impacts to customers of the Clean Energy Transformation Act (CETA). The two percent threshold for alternative compliance with CETA demonstrates the intent of legislators to limit incremental costs to maintain affordable electricity rates. Legislators were mindful of the balance between the incremental costs of compliance with CETA and other rate pressures that exist independent of CETA.

The original policy bills introduced at the request of Governor Inslee contained no incremental cost containment provisions (e.g., SB 5116 / HB 1211). Subsequent iterations of the legislation included variations of the two percent threshold moving from as high as five percent (e.g., SSB 5116), to three percent (e.g., 2SSB 5116). Ultimately, the Legislature adopted the two percent threshold in the final legislation.

The Legislature included the two percent threshold to manage the potential rate increase directly attributable to compliance with CETA, and to promote rate stability and prevent customer rate

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shock due to CETA implementation, while still ensuring ongoing investment towards the clean energy goals resulting from this specific policy.

For purposes of calculating the incremental cost, PSE offers two principles that may be helpful:

1) Aligning Incremental Cost with Revenue from the Commission Basis Reports:

The incremental costs associated with CETA implementation should be aligned with the Commission Basis Report to provide an accurate depiction of the impact on customer rates. PSE supports including relevant externalities—including the social cost of carbon—in planning and resource acquisition decisions. PSE also recognizes the importance of utilities including the social cost of carbon as a planning adder in making resource decisions. PSE does not, however, support the inclusion of the social cost of carbon in the baseline for the incremental cost calculation. As previously mentioned, the purpose of the incremental cost calculation is to promote the regulatory principles of gradualism and rate stability. The inclusion of externalities, such as the social cost of carbon, in the baseline for the incremental cost calculation will artificially inflate the baseline. Inflation of the baseline will then disguise (i.e., under-represent) the actual rate impact to customers from the actual costs of implementing the CETA legislation. Customer bills will then reflect not only the actual cost of resources acquired for CETA compliance, but also the inflated baseline costs resulting from the inclusion of the social cost of carbon. This will result in the total customer bill impact exceeding the annual two percent threshold, contrary to the legislative intent.

Again, the purpose of the incremental cost calculation is to ensure a gradual pace of resource additions that maintains rate stability as utilities move to the carbon-neutral and carbon-free requirements of CETA. To accomplish this objective, the Commission should develop rules or policies for the incremental cost calculation in a way that ensures an accurate comparison of incremental costs to the way customers actually pay utility bills, which is reflected in the Commission Basis Reports.

- 2) **Providing detailed, forecasted estimates:** The estimation of the incremental cost should match, as precisely as possible, a projection of how CETA-related costs will affect the utility's total revenue requirement. This would include the overall portfolio impacts on fuel costs, operations and maintenance expenses, wholesale market purchases and sales, etc. This is a complex analysis, but one that utilities locally and nationally have been engaging in for decades through their resource planning work and rate mechanisms. Again, the purpose of the incremental cost calculation is to ensure gradualism and rate stability in implementing CETA. As the Regulatory Assistance Project (RAP) noted during their presentation, simplifying the calculation may increase transparency, but it will make the calculation less accurate. A simplified approach could have the unintended effect of leading utilities to not

acquire renewable resources quickly enough, relative to what actually affects rates, or acquiring renewable resources too quickly, leading to unreasonable rate shock to customers. This would undermine the intent of the policy enacted by the Legislature, which PSE supports: to move towards carbon neutrality for its electric system as quickly as possible, subject to regulatory principles of gradualism and rate stability. For these reasons, as discussed below, PSE supports a hybrid approach of what the RAP presented at the March 17th workshop.

At the March 17th Workshop, the Department of Commerce and the UTC posed five discussion questions concerning the incremental cost of compliance mechanism. PSE's responses to these questions are provided below.

1. Are there implementation options, including what RAP presented, that seem most workable to you?

Of all the implementation options presented by the RAP at the March 17 workshop, PSE believes the combination or hybrid approach (i.e., proxy resources + market + portfolio optimization modeling) will be the most workable method of implementing the incremental cost calculation. This blended approach is also consistent with how PSE has modeled incremental costs under the Energy Independence Act.

To perform the incremental cost calculation for CETA compliance, PSE believes that CETA incremental costs must be: (1) projected as part of the Clean Energy Action Plan (CEAP) and Clean Energy Implementation Plan (CEIP) and (2) measured and accounted for as the CEIP is implemented. Compliance with CETA initially should be determined based on the projections provided within the CEIP and included in the Commission's order on the CEIP. The Commission's compliance determination would subsequently be subject to ongoing measurement and reporting of the utility's progress against the CEIP, costs, and CETA targets, as described further below.

Projecting the Incremental Cost in the CEAP and CEIP

In projecting the incremental cost, each utility would run two portfolio models and two annual cost projections. The first portfolio model would be a baseline, which is in the absence of any incremental CETA provisions. The second portfolio model would be the "CETA portfolio," which includes items that are "because of CETA." The CETA portfolio model would include specific proposed programs, to the extent practicable, to allow the electric supply portfolio to optimize to the best extent possible. The CETA compliant portfolio should internalize the impact of the SCC on resource decisions, but exclude the SCC as an internal cost, because it will not appear in rates nor in the Commission Basis Report. Portfolio model outputs may need to be modified to achieve cost projections, as some factors may be challenging to model inside the portfolio model (e.g. equitable distribution of benefits).

The annual cost projections under the two portfolio models would be compared to each other, which would determine the annual incremental cost. Then, the annual incremental cost would be

compared to the most recent utility Commission Basis Report, inflated at forecast inflation, or another forecasting method proposed by the utility and included in the CEAP and subsequent CEIP.

Measuring the Incremental Cost During CEIP Implementation

Once a CEIP is in the implementation phase, then the specific costs associated with CETA implementation must be measured. This could be accomplished by: (1) identifying the specific utility operations, programs, and costs that are part of the incremental cost calculation; and (2) allocating resource and energy efficiency costs to identify those that are due to CETA.

Identifying specific new utility operations, programs, and costs is straightforward and can be accomplished through setting up capital and expense accounting structures to measure specific costs. For example, if a demand response program was identified as part of a CETA portfolio, then the incremental costs of that demand response program can be tracked and measured. This may require establishing allocation methods, such as a deemed amount of costs that are incremental.

Allocating actual resource costs to identify those that are due to CETA is more complicated, as CEAPs and CEIPs are based on projections of future costs and program and resource availability, as opposed to the actual availability and cost encountered during implementation. Some of these costs can be well identified up front, whereas others may evolve over time, such as integration costs for renewable resources. As an initial simple way to start implementation, actually incurred costs could be compared back to projected costs in the approved CEIP. If actually incurred costs are lower, then plans could be adjusted to achieve targets faster, whereas if incurred costs are higher, then plans may have to be adjusted to move more slowly. With time, better knowledge and calculation methodologies around costs and benefits can be incorporated into each CEIP.

Accounting of Incremental CEIP Costs

As part of the filing and implementation of CEIPs, PSE believes that the rate flexibility allowed in CETA was intended to allow the filing of rate plans or riders to help accurately identify and account for CETA-related incremental costs. To that end, a two-percent rider that corresponds with the incremental costs contained in the CEIP should be filed contemporaneously, and the revenues from that rider should be specifically identified. Then, as actual incremental costs of CETA are incurred, as measured above, they can be associated to the two-percent rider.

Over a CEIP, the incremental costs of specific CETA measures and changes in the portfolio will be tracked and reported as part of a utility's annual report and compared to the utility's CBR.

Actual costs will not match exactly the projected costs in the CEIP. For this reason, there may need to be a mechanism to balance costs with spending within a CEIP, as well as a true-up mechanism from one CEIP to the next to deal with any spending variance against the plan and

any associated over- or under-collection, which should be allowed to be carried over into the next compliance period.

Compliance Determination

As stated earlier, compliance with CETA initially should be determined based on the CEIP and included in the Commission's order on the CEIP, with the Commission's compliance determination subject to ongoing measurement and reporting of progress against the CEIP, costs, and CETA targets. This allows the Commission to clearly understand the utility's plans and interim targets, but then also have ongoing information about the utility's progress towards meeting its plans. It is likely that there may be some deviation from plans and targets due to variations in generation, load, and programs. But, through reporting, the Commission can be kept apprised of these variations and their impacts.

Prudence Determinations

Separate from the issue of determining compliance is that of prudence of investments to meet CETA. This should be based on existing standards of prudence, which are outlined below:¹

- 1) Did the company consider appropriate alternatives?

This is primarily performed through the CEIP development and approval process. Because programs and resources take time to develop, the company should not have to reconsider all alternatives constantly, but rather during each CEIP. In other words, the prudence of the mix of resources contained in the CEIP should be determined at the time the Commission approves the CEIP, such as the balance of distributed and utility-scale renewable generation. The utility would still have to demonstrate that it acquired the resources in each category prudently, but not be required to rebalance resources between the categories.

- 2) Did the company update its information contemporaneously with decision-making and reassess?

Utilities should always use the best information available during decision-making. Because of the number of moving factors in CETA, including loads, supply and demand side resource market conditions and future regulation, constant reconsideration of a CEIP is not possible. However, in the development of a CEIP, a utility should identify any material changes it foresees could happen that would trigger a reconsideration of the mix and costs within a CEIP. These can then be monitored through the implementation of the CEIP. For example, if a utility is participating in a long-lead project, such as transmission, and something changes and the project is no longer economically viable, the utility should re-evaluate the project using updated information.

¹ The foundational prudence element of "need" is implicit in the legislative requirements requiring utilities to meeting the mandated clean energy targets.

3) Did the company contemporaneously document its decisions?

This existing practice is well understood and should be continued by the utilities to document why specific resources were chosen for each category the Commission approved in the CEIP.

2. Should the methodology that establishes incremental cost allow flexibility for different situations? For example, should the methodology allow for some incremental costs to be modeled through the IRP/CEAP process, and some incremental costs to be determined by comparing investments to proxy resources or justified in some other way?

Yes, the methodology that establishes incremental cost should allow for flexibility. While much of the incremental cost calculation will be projected through portfolio analysis, as described above in response to Question #1, there may be other costs, such as those associated with meeting the equitable distribution of benefits provisions under RCW 19.280.030(1)(k) that cannot readily be inputted into a model - and yet still should be included in the incremental cost calculation. Thus, allowing for some flexibility in how the calculation is performed will be important.

3. Comments to the Commission varied in terms of what expenditures should be included in the baseline for the incremental cost calculation. Please describe (1) which types of expenditures you believe should be in the baseline and (2) why those expenditures belong in the baseline.

PSE supports the incorporation of externalities in its planning and acquisition processes. However, as previously stated, the incremental cost calculation provision of CETA is neither a planning nor an acquisition process. As stated previously, the purpose of the two percent threshold is to promote gradualism and rate stability. Therefore, it is important to keep the analysis focused on how portfolio decisions will affect actual rates.

Incremental cost calculations should only include costs that will actually appear on customer bills. If externalities of any kind are included in the baseline and not actually included in customer bills, the two percent threshold will not align with customer bills. Thus, the analysis will not actually perform the intended policy goal, which is to manage rate increases resulting from CETA to two percent a year. By including only real costs that would affect customer utility bills, the incremental cost calculation will be simpler, more transparent, and align to the legislative goals of rate stability and ensuring affordability.

PSE's overarching concern is ensuring that the overall rate impact remains manageable to customers during the clean energy transition. Furthermore, if rate impacts are not appropriately managed in this transition to clean energy, there is a risk that customer support for the important energy and climate policy objectives in CETA may be lost. In determining the method for calculating the incremental cost of compliance, the Commission must not lose sight of this important policy constraint.

- 4. We would like parties to discuss what it means for a utility to demonstrate that it has maximized its investments in renewable and nonemitting energy. What guidance, if any, should the Commission and Commerce provide utilities on how it must demonstrate that it has maximized its investments in renewable and nonemitting energy?**

It would be beneficial if the Commission were to provide initial guidance on this provision. As indicated during the workshop, PSE has interpreted this provision to mean that a utility cannot invest in energy transformation projects (ETPs) until the utility has met the 80% carbon-neutral standard under CETA through renewable and non-emitting resources, *if* the utility is relying on the incremental cost of compliance mechanism in CETA. This interpretation seems to preclude a utility from investing in ETPs that might otherwise reduce carbon at a lower cost than renewable and non-emitting resources prior to meeting the 80% standard – which may run counter to some of the overarching goals of CETA itself. If the Commission finds it has the authority to allow utilities to use energy transformation projects in lieu of adding resources in situations where the ETP is a more cost-effective way to reduce greenhouse gas emissions, PSE would be supportive, as it may be the most cost-effective way to achieve CETA’s goals.

- 5. In its comments to the Commission, Public Counsel wrote that it is unclear whether the 2% threshold is intended as 1) a maximum limit on the amount a utility can spend in a compliance period, 2) a maximum limit on the amount customers may be charged for CETA compliance, or 3) simply an option a utility may choose to show compliance with its CETA obligations that does not impact total spending or cost recovery within a compliance period. How should the commission interpret the statute? Other parties should weigh in after Public Counsel.**

It is PSE’s position that the two percent threshold is a compliance option beginning in 2030 – a means of showing it has met its CETA obligations. Prior to 2030, the law is less clear, and clear guidance from the Commission would be helpful. As indicated previously, one of the main objectives of the two percent threshold is to ensure that the requirements of CETA do not increase customer rates too quickly. Although CETA may not require utilities to spend two percent per year prior to 2030 in order to rely on the incremental cost of compliance mechanism, PSE believes the two percent threshold can be viewed as general guidance from the Legislature that spending an additional two percent a year prior to 2030 may be appropriate, and that because the law does not specify a threshold prior to 2030, the Commission has the flexibility to establish appropriate spending. Because the law is less clear prior to 2030, guidance from the Commission would help ensure utilities are making the appropriate progress towards CETA targets, while keeping rate impacts affordable for customers.

PSE appreciates the opportunity to provide responses to the questions identified in the Commission’s Notice of Opportunity to File Written Comments. Please contact Kara Durbin at

425-456-2377 for additional information about these comments. If you have any other questions please contact me at (425) 456-2142.

Sincerely,

/s/ Jon Piliaris

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