

Exhibit No. ____ (KLE-6)
Dockets UE-111048/UG-111049
Witness: Kenneth L. Elgin

BEFORE THE WASHINGTON STATE UTILITIES AND TRANSPORTATION COMMISSION

**WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,**

Complainant,

v.

PUGET SOUND ENERGY, INC.,

Respondent.

**DOCKET UE-111048
DOCKET UG-111049
(Consolidated)**

**EXHIBIT TO
TESTIMONY OF**

Kenneth L. Elgin

**STAFF OF WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION**

Excerpts from Commission Orders

December 7, 2011

TRANSPORTATION COMMISSION,

Complainant,

vs.

PUGET SOUND POWER & LIGHT
COMPANY,

Respondent.
.....

CAUSE NO. U-73-57

SIXTH SUPPLEMENTAL ORDER

The above-entitled cause involves tariff filings by Puget Sound Power & Light Company by which respondent proposes to effect a general increase in its rates and charges for electric service furnished within its operating territories in the State of Washington. Hearings, pursuant to notices given in accordance with requirements of Title 34 RCW, were held at Olympia, Washington, on December 27 and 28, 1973; on January 2, 21, 22, 23, 24 and 29; July 25, 26 and 29; August 13 and 19; and September 9 and 10, 1974, before Chairman Donald H. Brazier, Commissioner Francis Pearson, Commissioner Elmer C. Huntley, and Examiner William Metcalf.

After hearing oral argument by parties on September 20, 1974, the Commission issued, on September 27th, a proposed decision in this matter. Thereafter, in conformity with a time schedule set forth in the proposed order, exceptions were filed by respondent and the Commission's staff; respondent replied to the staff's exceptions. Counsel for the consumer public submitted a statement supporting (1) the proposal to impose a five percent surcharge on all electric power delivered pursuant to commercial and industrial tariffs to be filed by respondent and (2) the expression of their intent to adopt rules governing giving of notice by utilities of their intent to seek rate increases. All parties waived further oral argument as provided for in the proposed order. The following order reflects the Commission's decisions on issues raised by parties in their pleadings.

In addition to exceptions, respondent points out two errors in the transcript of this proceeding. The figure \$12,700,111 appearing on page 1150, line 10, of the transcript should read \$12,007,111. Testimony was omitted at page 1652, line 4, of the transcript; respondent's exceptions set forth the omitted material. Respondent's statement of these errors will be viewed as motions to correct the transcript, and it appearing that the suggested corrections are proper, the motions will be granted.

The parties were represented as follows:

COMPLAINANT: WASHINGTON UTILITIES AND TRANSPORTATION
COMMISSION, by Frank P. Hayes, Assistant
Attorney General, Temple of Justice,
Olympia, Washington 98504

The Commission affirms the pro forma test year approach as the overall basic approach appropriate for determining Puget's revenue deficiency in this proceeding. As noted above, company and staff made their presentation to the Commission by using the twelve months ending June 30, 1973, as a test year for rate-making purposes. There is no dispute over the propriety of using this period as a test year, and the Commission finds that it is appropriate for use as a test period.

To summarize, the purpose of this proceeding is to develop evidence from which the Commission may determine:

1. An appropriate rate base;
2. The fair rate of return thereon;
3. Results of operations for an appropriate test period;
4. The amount of any revenue deficiency to reach the level of fair rate of return; and
5. The spread of any such revenue deficiency through the rate structure of the company.

With these preliminary comments, we turn to the basic factual questions in light of the evidence offered by parties to this Cause.

III. RATE BASE

Respondent calculates its pro forma test period rate base to be \$444,670,241 (Exhibit No. 2); the staff's presentation proposes an amount of \$435,651,459 (Exhibit No. 49). The staff's lower figure is attributable to two factors: the company utilizes a test year-end rate base, while the staff averages each month's balance; and the staff did not include in rate base that portion of certain pro forma expense adjustments requiring capitalized treatment as to which the company gave rate base status. These two factors will be considered separately.

Year-End Versus Average Rate Base

Respondent proposes a year-end rate base, arguing that such a calculation will be essential to its ability to achieve, under post-rate-case conditions, the rate of return allowed by the Commission. As respondent sees the situation, in its last rate case (U-71-30), based on the test year 1970, a net utility operating income for a twelve-month period being divided by the average rate base for the period, resulting in a percentage labeled "average rate of return,"

if the relationship of these two factors under actual post-rate-case conditions differs from the relationship established and accepted in the pro forma test year, such actual post-rate-case period return will differ from the return anticipated based upon the pro forma figures utilized. On actual operations in the period subsequent to the U-71-30 order, Puget did not achieve the rate of return that the rate increase therein granted was intended to produce. For the first full year after the new rates were in effect, net utility operating income was up only 5.95 percent, whereas average rate base was up 13.3 percent, both compared to the pro forma figures upon which the new rates were established. The result in this changed relationship is a rate of return below that anticipated by the increase. To correct this situation, Puget here requests an end-of-period rate base for rate-making purposes, along with "pro forma entries to operating income that will more accurately reflect current cost levels".

It is noted that the company's proposed end-of-period rate base does not include adjustments reflecting end-of-period revenues, or customers.

The rate base, consisting primarily of net plant in service and other properties used and useful during the test period, if averaged over such test period, provides a workable basis upon which a rate of return may be earned in harmony with the utility service being rendered. If an end-of-period rate base is used, in theory, revenues and expenses should be adjusted in an attempt to properly correlate the investment and utility service provided.

Of course, even when revenues and expenses are brought into consonance with a year-end rate base, the resultant gross revenue deficiency to be assessed the rate payers on the year-end basis will be higher than a determination based upon an "average" rate base. As an example, assume a situation whereby the percentage relationship of year-end rate base to average rate base is 1.25 times, the same as the relationship of net operating income at year-end is to the average. A comparison of the gross revenue deficiency impact follows:

	Rate Base	
	Average Basis	Year-End Basis
Rate base	\$1,000,000	\$1,250,000*
Net operating income	75,000	93,750*
Rate of return	7.5%	7.5%
Net operating income deficiency (Line 1 x 4 - 2)	12,500	15,625
Gross revenue deficiency (.50 conversion factor)	25,000	31,250

* @1.25 times average basis

The resulting gross revenue deficiency will also be 1.25 times higher, year-end over average basis.

Historically the Commission has accepted the average rate base concept as being an appropriate tool in the measurement of earnings level. It has not, however, discounted the validity of a year-end rate base where special conditions exist, such as unusual growth in plant at a faster pace than customer growth and customary rate-making treatment is deficient. When a special condition is presented and shown to warrant year-end rate base treatment, consideration should be given to the revenue producing capabilities of plant added at the end, or near the end, of the test period.

The special situation cited that may arise where year-end rate base treatment should be preferred over the "average" method includes the situation where a combination of plant expansion and operating expenses are accelerating at a faster pace than revenues. And in that situation, the year-end rate base would be preferred only when remedies, in the conventional manner of adjusting for expansion and rising costs on a prospective basis, appear to be insufficient.

Respondent's proposal to utilize an end-of-period rate base on the ground it failed to achieve the intended rate of return (and submitting that the average rate base increased two and a quarter times greater than the growth in net operating income) has been given careful consideration in light of the entire record. Recognizing that a year-end base (i.e., larger investment base) requires correspondingly more dollars from customers through higher rates (without increasing the rate of return), an analysis of the company's current rate of return deficiency assumes added significance.

The previous case, on a prospective basis, contemplated that an average rate base of \$370,902,700 would produce net operating income at the level of \$28,188,605, producing the allowed fair rate of return of 7.6 percent. Rate-making theory presupposes that as time goes on added investment base above the level contemplated in the rate-making process will bring added income in balance with the return authorized. Here, the record indicates that the first full year's operation after the date when the last increase in rates became fully effective, actual operations showed an average rate base of \$420,537,781, net operating income of \$29,866,534, producing a rate of return of 7.1 percent. It appears, with investment base being increased two and a quarter times greater than net operating income, that during this short interval the added investment base did not contribute to net operating income sufficiently to maintain the anticipated rate of return level. Based upon the same comparatives, actual operating revenues increased 17.77 percent and actual total deductions from operating revenues increased 22.58 percent.

The indicated conclusions from these statistics are as follows: (1) percentage revenue increases exceeded those for the average rate base, standing alone indicates the newly added plant's unit cost per KWH is higher than such costs prior to its inception, and results in a deterioration of the required rate of growth in net operating income to maintain the anticipated rate of return; (2) the deficiency in rate of return cannot be wholly attributable to item (1), an additional factor is increased costs, other than those associated with added rate base, were not recognized or presented before the Commission in the previous case and given pro forma treatment.

The record indicates a substantial portion of the increase in average rate base from the previous test year to that being examined here is due to steam plant facilities at Centralia. In this proceeding both company and staff have submitted adjustments giving pro forma effect to total investment and expenses in the Centralia steam plant, even though a portion thereof was not included in plant-in-service on the books at the close of the test period. In the previous case a wage settlement by Puget has been made and proposed as an additional pro forma adjustment but was denied upon the record made in that case.

In summary, Puget's inability to achieve the anticipated rate of return approved by the Commission in the previous case is the result of two principal factors: (1) the added plant injecting higher unit costs of production; and (2) inflationary impact impairing Puget's historical ability to absorb wage and sundry expense increases. In the past, growth in revenues and economies in operations due to technological improvements have allowed respondent to absorb these expense increases without impairment of rate of return. Other minor factors in the company's failure to earn at the anticipated rate of return level include stockholder absorption of reduced rates in competitive areas.

It is recognized that any attempt to precisely account for an increase or decrease in earnings level from one rate case period to another is fraught with pitfalls. The mere failure of a utility to tighten its expenditure belt, particularly during this inflationary period, can lead to an inefficient operation where the rate of return anticipated by the regulatory agency will not be achieved. The Commission considers every party in a proceeding such as this one to have an obligation to bring forth and introduce whatever evidence it can find relating to both current and prospective operations so that the Commission will be able to analyze situations and exercise its judgment as accurately as it possibly can.

Evidence and adjustments submitted in this cause by both company and staff are decidedly improved over previous efforts

to recognize the impact of current economic conditions on rate-making considerations. Accordingly, the criteria for year-end rate base, in our opinion, has not been met in this cause. Inherent in the criteria establishing acceptance of an end-of-period rate base is that such a rate base is to be used in determining revenue deficiency only, and the average rate base applied subsequently.

Respondent has not demonstrated that use of a year-end rate base will achieve the end respondent contends will result from using it. The average rate base concept will be accepted for purposes of this proceeding.

Capitalized Labor and Other Costs Charged to Rate Base.

Historically respondent has capitalized certain costs of labor, employee retirement plan, FICA, and unemployment taxes for book purposes. In making its pro forma adjustments, Puget increased that portion of these costs that was capitalized and included such increase in rate base. The argument for including these construction costs in the rate base is that they have to do with the future the same as other pro forma adjustments such as wage increases.

One of the basic premises in the theory of rate making is that rate base is generally restricted to plant in service. The investment in construction work in progress is allowed as an added interest charge at a rate equivalent to the prevailing rate of return. Such treatment is not given to wages and other items charged to expense as such expenses will never be included in future investment base. Accordingly, the Commission finds that these capitalized items should not be included in the rate base.

* * * * *

The Commission finds, on the basis of the foregoing discussion and conclusions, that the staff average rate base in the amount of \$435,651,459 is the proper rate base to be adopted for respondent for use in this proceeding.

IV. RATE OF RETURN

The last proceeding before this Commission involving rate increases for respondent was Cause No. U-71-30. By order issued April 1, 1972, in that proceeding, the Commission found that a rate of return ranging from 7.60 percent to 7.75 percent was proper, and it authorized the company to file tariff revisions designed to produce a rate of return at the lower limit of that range. The Commission also found that the appropriate range for the cost rate of common equity for respondent was 11.13 percent to 11.63 percent.

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BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION,)	
)	
Complainant,	)	CAUSE NO. U-75-24
)	
vs.)	
)	
PACIFIC POWER & LIGHT COMPANY,	)	SECOND SUPPLEMENTAL ORDER
)	
Respondent.	)	(Rejecting Tariff Filing and Authorizing New Filing)
.....)	

The above-entitled cause involves tariff revisions to its Tariff WN U-72 filed by Pacific Power & Light Company on April 18, 1975. The revisions would increase charges and rates for electric service rendered by the company in certain areas of the State of Washington. Hearings, pursuant to notices given in accordance with requirements of Title 34, RCW were held at Olympia, Washington, on June 16 and 17; July 23, 24, and 28; and August 18, 1975, at Olympia, Washington; and on August 21, 1975, at Yakima, Washington, before Chairman Donald H. Brazier, Commissioner Elmer C. Huntley, and Commissioner Frank W. Foley, and Legal Examiner William Metcalf.

The parties were represented as follows:

COMPLAINANT: WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION
By Frank P. Hayes and
Douglas N. Owens
Assistant Attorneys General
Temple of Justice
Olympia, Washington 98504

RESPONDENT: PACIFIC POWER & LIGHT COMPANY
By Gerard K. Drummond and
Leonard A. Girard
Attorneys at Law
1400 Public Service Building
Portland, Oregon 97204

CONSUMER PUBLIC:

PEOPLE OF THE STATE OF WASHINGTON
By Patrick R. Cockrill
Special Assistant Attorney General
P. O. Box 437
Yakima, Washington 98907

On April 18, 1975, Pacific Power & Light Company, identified herein as respondent or the company, submitted numerous revisions to the rates and charges named in its Tariff WN U-72; the tariff governs the charges the company makes for retail electric service rendered in certain parts of this state. The filing was designed to increase annual gross revenues by approximately \$3,455,000 or 12.63 per cent. It appearing that the interest of the public might be injuriously affected by the proposed rate increase, the Commission suspended the filing by order issued April 25, 1975. This order also required hearings on the revisions, the company having the burden of proving that rate increases are just and reasonable, and hearings were held as stated above.

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the company used in its direct case, and the company either concedes or does not dispute the staff's analysis of plant held for future use. The staff's view will be adopted.

Company exhibits and staff exhibits state contributions in aid of construction as \$741,000. This figure will be adopted.

The company seeks to deduct from its rate base \$17,000 for customer advances for construction. The staff contends that this deduction should not be made because the money will be refunded to customers. The company seeks to add to its rate base an amount of \$1,486,000 for working capital materials and supplies; the staff objects to the addition on the ground that the company has not shown that investors supplied the money for the items included. Proper handling of customer advances for construction and working capital materials and supplies are issues the Commission considered in the last general rate filing by respondent, Cause No. U-74-8, Second Supplemental Order, November 20, 1974. The company's position was rejected there, and no reason is advanced here for reversing our holdings. The position of the staff on these two issues will be accepted.

2. Construction work in progress.

The Commission has not previously allowed the cost of uncompleted construction projects to be included in a company's rate bases since rate base has normally consisted of the total of plant facilities actually used to provide the service customers pay for and, further, is the item used to calculate the amount of the return shareholders are to receive on their investment. We have heretofore held that customers should not pay, through rates, for plant not providing service to them and that shareholders should not be given a return on such plant facilities.

However, upon submission of the company's direct case, the staff of the Commission determined that it has now become necessary in limited cases to transfer some of the burden of current plant financing to the present ratepayers rather than postponing the entire burden to the future until after the plant is actually in service, and it presented testimony and evidence through Mr. E. Martin Massey in support of this determination.

In its direct case the company disclosed a substantial increase in its expenditures for plant. Its Exhibit No. 1, sponsored by Mr. John H. Geiger, shows that from 1967 through 12 months ended September 30, 1974, the company's gross system-wide capital expenditures for electric production, transmission, and distribution plant total \$823,609,000. Almost half of this amount applies to 1973 and 1974, the last two years of this eight-year period. The exhibit shows that the company's gross investment in electric plant increased from \$746,559,000 in 1967 to \$1,138,544,000 at September 30, 1974, an increase of \$391,985,000, or 53 per cent.

The company's expenditures for electric plant classified as construction work in progress totalled \$302,188,000 at September 30, 1974. This amount is nearly half of the entire gross investment in electric plant as of the end of 1967. Mr. Geiger testified that expenditures for plant classified as construction work in progress are expected to remain at increased levels for some period of time. In 1964 construction work in progress, was slightly in excess of \$5,000,000, and in 1974 it was over

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\$300,000,000 (Exhibit No. 21). Table 11 of Exhibit No. 1 summarizes the company's anticipated plant additions and replacements for the years 1975 through 1979. More than one and a half billion dollars for plant additions and replacements is projected, the majority of which is for production plant. Mr. Geiger stated that the company finds itself having to become more and more self-sufficient in energy production, with consequent greater and greater emphasis on construction of new plant.

In order to evaluate the impact of construction work in progress, the staff undertook an analysis of the amounts for it for a ten-year period ending 1974 for the major electric, gas, and telephone utilities operating in this state. Net plant was compared to construction work in progress each year. The study disclosed that construction work in progress is a minor element in terms of percentage of net plant for the two largest gas distribution companies. For the two largest telephone companies, the percentage of construction work in progress to net plant has remained relatively small and relatively constant in the case of one company, and for the other it has remained relatively small and has decreased. However for the three largest electric companies operating in this state the staff found that respondent had experienced a dramatic rise in construction work in progress as a percentage of net plant beginning in 1970 and continuing through 1974; Puget Sound Power & Light also experienced such a dramatic increase, starting in 1973; while the third company, Washington Water Power, does not show a similar pattern of growth in construction work in progress.

The percentage of construction work in progress to net plant for respondent disclosed by the staff's study is:

1964	0.91
1965	2.03
1966	1.05
1967	1.98
1968	1.83
1969	6.03
1970	14.21
1971	20.80
1972	10.22
1973	13.79
1974	22.97

The staff proposes that we include in respondent's rate base (1) construction work in progress pertaining to major production plant and directly related system transmission plant in order to afford a rate of return on the cost of such construction, and (2) that we add back to test year operations the proforma allowance for funds during construction related to this plant. In presenting his evidence and arguments in support of the need for reappraisal of construction work in progress treatment, Mr. Massey emphasized that his analysis does not show for telephone utilities and gas utilities the need for improvement in cash flow shown for respondent and one other electric utility.

The Commission recognizes that the relationship of thermal production construction work in progress to total utility plant in service has approached an extreme level for respondent in the test period. Attendant upon this construction is a sizable need for current financing with the prospect of attaining in-service status only after a substantial time of construction.

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The addition of construction work in progress (production and related transmission facilities only) to rate base proposed by the staff will add, after taxes, that level of earnings below which allowance for funds during construction has failed to yield the return on production and related transmission construction work in progress determined by this Commission as necessary to maintain adequate credit. The rate making cost of this adjustment is borne by the current ratepayer. A significantly greater amount would remain by staff adjustment to be borne by future ratepayers.

Counsel for the People of the State of Washington is concerned with the assessment of costs to current users of future service benefits; with the fact that acceptance of production and related transmission facilities, construction work in progress, in rate base may set precedent for future proceedings that make general construction work in progress inclusions inescapable; and that acceptance of the staff's proposal will remove a significant anti-inflationary brake on spending since the company controls its construction projects. In the opinion of the Commission, the assessment of a portion of the future service cost to present users is necessary and equitable. As to establishing future precedent, the rationale supporting the staff position is well thought out and permits inclusion of construction work in progress items in rate base only for major long term projects related to power production facilities.

For construction work in progress, Mr. Massey's evidence sets forth the Washington portion of total company major production plant and system transmission plant, deducting plant cost previously given proforma treatment, to derive an amount of \$23,286,031 to be included in the Washington rate base. For allowance for funds during construction, Mr. Massey adds to the actual allowance for funds during construction for major production and system transmission a restatement amount reflecting the rate change (8 per cent) experienced on July 1, 1974, with a deduction for the interest applicable to certain plant previously given proforma treatment to derive a figure of \$1,655,792 which is added back to operations. The proposed adjustments will be accepted.

Treatment herein accorded to construction work in progress constitutes a major departure from normal rate-making procedures in this state. We take this step only after the most serious deliberation as to its propriety. We recognize the concerns expressed by counsel for the people of the State of Washington. However, we do not agree that our treatment in this case can appropriately be advanced as a persuasive precedent in cases other than those involving electric utilities and then only as to those wherein it is demonstrated that construction work in progress is shown to represent a dramatic, increasing percentage of net utility plant. It is not the magnitude per se of construction work in progress, or the increase in the amount thereof, that warrants deviation from normal regulatory procedures. Rather, the problem arises from the coinciding of these two factors with construction work in progress becoming a soaring percentage of net plant. Deviation from normal procedures becomes justified where all those factors are shown to exist.

It also needs to be noted that those factors co-exist in the electric utility industry and during the period of transition from a relatively low cost hydro supply base to an energy supply base becoming increasingly dependent upon higher priced thermal production. Further, it is only major production plant, and associated transmission plant, that is being accorded this treatment. Increasing reliance on electricity as an energy source justifies

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the special treatment herein being accorded to give greater assurance of meeting the requirements of even existing customers. We will reexamine this treatment whenever the situation indicates that changed circumstances no longer justify continuation of the approach we are following in the instant case.

The foregoing findings are summarized as follows:

Average Rate Base -- State of Washington
 (Five-state allocation basis)
Year ended September 30, 1974

Average Rate Base - Actual	
Utility plant in service	\$ 161,088,000
Less: Depreciation reserve	<u>27,381,000</u>
	133,707,000
Add: Plant held for future use	717,000
Construction work in progress	23,286,000
Deduct: Contributions in aid of construction	<u>741,000</u>
Average rate base -- proforma	<u>\$ 156,969,000</u>

Fair Rate of Return

Rate of return is the amount of money respondent is given an opportunity to earn, after taxes and operating expenses, expressed as a percentage of its rate base. Determination of the fairness and reasonableness of the rate of return requires first a determination of a capital structure for a public utility that is the least costly to maintain and yet which can assure stability of the company's credit position. These issues are not controversial in this proceeding. Respondent does not seek an increase in the rate of return found reasonable by the Commission in the last order granting rate relief to respondent. That order, U-74-8, *op. cit.*, found 8.76 percent to be a fair rate of return for the company, and parties here agree to the taking of official notice of that order and to an updating of capital structure and cost rates based on evidence submitted by the company in its Exhibit No. 4. Accordingly, we find the appropriate capital structure and fair rate of return to be as follows for purposes of this proceeding:

	<u>Ratio</u>	<u>Cost Rate</u>	=	<u>Weighted Cost Rate</u>
Debt	57.58%	6.83%	=	3.93%
Preferred stock	7.77	7.36	=	.57
Common equity	32.89	13.00	=	4.28
Deferred income taxes associated with ac- celerated amortiza- tion	1.76	-	-	-
<u>Composite (Fair Rate of Return)</u>				<u>8.78%</u>

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND)
TRANSPORTATION COMMISSION,)
Complainant,)
vs.)
PUGET SOUND POWER & LIGHT)
COMPANY,)
Respondent.)
.....)

CAUSE NO. U-78-21

SECOND SUPPLEMENTAL
ORDER
(Rejecting Tariff Filings
but authorizing new Filings)

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The company suggests that ratepayers do not pay debt service costs until new rates go into effect and that the accrual is a working capital accrual, that the treatment suggested by staff is contrary to Commission principle, that the funds come from eroded earnings, that power costs have inflated since 1976, and that the challenged item is a prepaid expense which will occur after the present case is closed.

Initially, the Commission commends the company for prudently seeking out, developing, and making available to its customers the substantial new source of hydro power which these generators represent. The enhancement of the company's ability to meet peak demand is consistent with the company's public service obligations.

More specifically, the Commission agrees that the item is, though not working capital, a prepaid expense and that it is an item which was provided by shareholders rather than by ratepayers. In so doing the Commission does not abandon the concept of upward or downward pro forma adjustments to rate base to reflect out-of-period events affecting major generating or transmission facilities in appropriate circumstances. The Commission also rejects as impractical any suggestion in the present case that implementation of new rates be bifurcated in time to coincide with the initiation of Rock Island debt service payments by Puget. The Commission adopts the company treatment of Rock Island power costs and rejects the staff proposed alternate treatment method.

E. Construction Work In Progress

To permit a company such as Puget to include construction work in progress in rate base is to authorize it to obtain from present rates and tariffs revenues specifically authorized for allocation to the financing costs of constructing major electric generating or associated transmission projects, the funds to be paid out before the in-service dates of projects so recognized. In recent years, each of the three investor-owned utilities in the State of Washington has begun a massive thermal generating facility construction program. Each utility in the course of its program has incurred unprecedented construction financing costs, and each faces the prospect of continued construction cost escalation for the foreseeable future. The Commission for over three years has recognized the companies' financial burden by permitting partial inclusion of construction work in progress in test year rate base.

The Commission had historically treated rate base as consisting only of plant actually in service, which is that plant used to provide present ratepayers with whatever service the particular utility furnishes. The Commission had likewise used rate base so defined to determine the amount of return permitted a utility's common shareholders. Beginning in Cause No. U-75-24 and continuing to date, however, the Commission has acknowledged the need for an exception to the historic definition of rate base in the case of electric utilities facing massive long-term construction expenditures for production and transmission plant.

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The Commission, presented with a comparative analysis of construction work in progress impacts on all major investor-owned electric, gas, and telephone utilities in the state, determined in Cause No. U-75-24 that the Pacific Power & Light Company, respondent therein, should be permitted to include in its test year rate base construction work in progress for major production and associated transmission plant offset by adding to test year operating results a proformed amount representing an allowance for funds used during construction ("AFUDC") of the projects so authorized for inclusion. In doing so, the Commission recognized the necessity of transferring some of the burden of current plant financing from future investors to present ratepayers. The Commission determined that to permit recoupment of the level of earnings necessary to maintain credit adequate for the financing of major production and associated transmission construction programs in the case of certain electric companies, a level not being provided by allowance for funds used during construction, an electric company could include in rate base construction work in progress if offset by AFUDC, but only where the demonstrated cost of such construction stood at a "dramatic" percentage of net utility plant, and where the magnitude of construction costs represented a substantial increase from previous levels of construction financing undertaken by the company. In subsequent cases, the Commission applied the principles set forth in Cause No. U-75-24 to the circumstances of The Washington Water Power Company and Puget Sound Power & Light Company and determined that those two companies should be permitted to include construction work in progress in rate base offset by AFUDC in test year results of operations. In Cause No. U-77-25, the Commission determined the propriety of continuing recognition of an electric company's construction financing burden when such burden continued at levels previously recognized as sufficient to justify the inclusion of construction work. The Commission method of offsetting allowed construction work in progress by recognition of AFUDC apportions financing costs of current plant construction between current ratepayers and future ratepayers, with the great bulk of costs to be borne by future ratepayers. The method does permit shareholders some return on plant under construction.

The inclusion of part of CWIP in rate base, by which the Commission has treated an extant problem in traditional financing of massive electric production and associated transmission facility construction, has come under strenuous attack in the instant case. On the one hand, Puget has contended for a decrease in the AFUDC offset employed in the Commission's calculation method, which decrease would result in a sharp increase in the portion of the construction financing burden borne by present ratepayers. On the other hand, intervenors POWER and FERN and counsel for the public have contended that no construction work in progress whatsoever should be permitted in test year rate base or, alternately, that only construction work in progress for licensed and sited facilities should be permitted. Staff recommends a continuation of the Commission's previously adopted method of treating CWIP. For reasons set forth below, the Commission is of the opinion that its previous method of apportioning the cost of financing Puget's construction program between present and future ratepayers should apply in the present matter.

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An effective increase in construction work in progress over the amount the Commission has heretofore authorized could not be permitted absent a showing that included as one element a demonstration that the company could not finance its construction program under the method previously adopted by the Commission. There is nothing in the present record to show that adherence to the Commission's established method of treating construction work in progress would render the company unable to finance its construction program.

The company in its rebuttal case contended that retention of the present method of allocating CWIP costs would prevent the company from earning the rate of return advocated by staff in this proceeding. The company based its contention on a 1979 cash flow demonstration depicted in Exhibit 115. That exhibit, tantamount to a forecast test year, is not readily verifiable and is totally insufficient to meet the company's burden on the issue. The exhibit is a composite of estimates of events, revenues, and expenditures made by persons not offered as witnesses in the instant proceeding. The events included will not occur, in the main, until after this order issues; moreover, the events cannot be precisely calculated from present data. No meaningful comparison between the events hypothesized in Exhibit 115 and known and measured events from prior periods can be made. Details of expenses are lacking and, contrary to Commission rule, effects of anticipated inflation are included. Demonstration of an insurmountable construction financing burden, given application of the present Commission CWIP method to an electric utility's test year rate base, is an indispensable element of any demonstration of the present method's unacceptability, and no such demonstration has been reliably made in the instant record.

Intervenors POWER and FERN and counsel for the public contend that construction work in progress should not be included as a rate base item. They advance several reasons in support of the position. Some of the reasons are concerned with the nature of the charge to be allocated to present ratepayers, while others focus on the propriety of the projects to be built. Concerns with the type of charge levied against ratepayers include construction work in progress as a form of present payment for future use, the uncertainty attendant upon contribution for a project not yet in service, the inefficiency of the method as a fund raiser due to tax effect, and characterization of the item as an involuntary capital contribution offering no ownership or return to the contributor.

Concerns related to the projects include a contended lack of need for the projects, the posited existence of alternate energy producing or conserving methods and a specific objection, on safety grounds, to nuclear power. It is true that not all present ratepayers will benefit from power produced by the projects for which Puget herein seeks rate base inclusion. However, the continuation of the construction program and the company's ability to finance that program, including its ability to maintain debt coverages, reflect generally on the company's ability to finance for present as well as for future customers.

CAUSE NO. U-78-21

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It is not arguable that a plant in service is a more reliable object of funding than is a plant under construction, and service from projects under construction cannot now be flatly guaranteed. However, the likelihood of a needed project's being timely completed is influenced by a utility's ability to raise capital for the project and by a regulatory body's creating a climate which is not inhospitable to the funding of such necessary construction. In other words, the act of funding financing costs of CWIP in some measure enhances the certainty of the project's completion.

As to rate base inclusion of CWIP being an inefficient method of raising funds the criticism is no different from that which could be levied at any other item in the present case. Having for over three years acknowledged the exceptional circumstances of electric utilities which require the inclusion of construction work in progress in rate base, the Commission is nonetheless powerless to accord this item any separate treatment as to tax consequences.

Increased revenues resulting from construction work in progress have been termed an involuntary capital contribution. The Commission recognizes the involuntary nature, but once the propriety of the contribution has been determined it is in no sense more an involuntary item than is any other item leading to an increase in the company's rates. Also, the Commission notes that some benefit does flow from the contribution in that company financing is given stability, and that gradually ascending contributions during the course of construction of major generating and associated transmission projects not only avoid sharp increases at future in-service dates but will result (as has been described in previous Commission orders) in lower overall rates than would be the case should no project costs be recovered before in-service dates.

Relying notably on a forecast presented by Dr. Robert Halverson, intervenor POWER contended that there was no need for a construction program of the magnitude which Puget has undertaken. Assuming without so deciding that the contention has a proper legal base for Commission decision, the forecast presented by Dr. Halverson is unreliable on several grounds. Dr. Halverson's forecast is not an independent forecast for Puget but rather a composite of a review of a Puget forecast and certain statewide projections. More specifically, Dr. Halverson projected energy loads for 1980 and peak loads for 1984 which accorded with actual 1978 energy and peak load demands experienced by the company. Even if Dr. Halverson's forecast were taken at face value, there would be very little margin afforded the company in meeting its service obligations.

The determination that investment in a particular generating project under construction is a prudent investment is implied in any determination that construction work in progress should be included in rate base. In light of those projections available to the Commission which build most closely on the company's actual operating experience, the Commission must conclude that the investment herein proposed is prudent. In regard to the Skagit project, the Thermal Power Plant Site

Evaluation Council of the State of Washington has previously determined a specific need for the project in meeting future demand from company customers. It is conceivable, though remote, that circumstances might arise wherein a project for which a need had been determined could at a later point be found to be not a prudent object of investment, but certainly no such showing has been made on the instant record.

Regarding alternate methods, the Commission heard evidence both as to alternate sources of electricity and as to conservation. In regard to methods and devices, discussion was had on some sources which may prove functional in warmer, sunnier climates such as California but which in climatological conditions such as those experienced in Puget Sound were not demonstrated to be effective. Solar power, wind power, and other such alternatives remain objects of keen interest to the Commission, but no reliable cost effective method was demonstrated on the instant record.

Puget has increased its activities in the conservation area, having recently embarked on a program to fund energy saving improvements in the homes of residential customers. The Commission does not see in the instant record any specific improvement in the company conservation program which can be implemented with sufficient rapidity to offset the urgent need for completion of the company's construction program. However, there is a considerable effort which should be made in both conservation and in alternate generation for which the Commission could offer the company additional direction. Consequently, this order will require that the company submit to the Commission within six months an inventory of all presently unused or underused electric generating or cogenerating sites having existing untapped sources of power at or exceeding a capacity of 5 MW and situated in the company's service area or within 50 miles thereof. The Commission further requires as part of the inventory a specific statement from the company as to the prospect (including company plans for utilization) and cost-effectiveness of obtaining electric power or other power which may be substituted for electric power from such sites and sources. Examples might include industrial facilities producing sufficient quantities of now unused steam, moderately sized hydroelectric sites, or under-utilized accumulations of wood chips. As to conservation, the Commission is concerned with and mindful of the company's residential space heating conservation program. In Cause No. U-78-05, frequently mentioned in the instant record, the Commission is considering a general restructuring of the rates charged by private electric utilities in the state with conservation being one of the goals primarily considered in any such restructuring. In its inventory to be submitted in six months, the company should specify any methodologies for further improved savings in residential electrical consumption or especially in commercial and industrial consumption that may be implemented, as well as a discussion of the feasibility of residential and commercial reverse meter cogeneration.

Many of the objections raised to the inclusion of construction work in progress in the rate base were advanced

on the ground that nuclear power is inherently unsafe and therefore imprudent. The Commission has no jurisdiction to determine the safety of nuclear as opposed to nonnuclear generation. The field has been preempted by the Federal Government and, consequently, the Commission will not address the question of safety.

Counsel for the public and intervenor POWER alternately contend that, should the Commission not exclude the entirety of construction work in progress from rate base, it should include only those CWIP costs associated with licensed and sited plants. The prime justifications for this position are (1) that licensing is a reasonable guarantee that a project will be built and therefore an assurance that the ratepayer's money will go to the proper expense, (2) that the licensing process serves as an independent test of the company's judgment as to siting, magnitude, design, need for, and timing of a project, and (3) that construction costs incurred before licensing are small in comparison to those incurred after licensing. The Commission is well aware of the special concern that attaches to any portion of a rate increase which is levied for exceptional circumstances, but must also consider the urgency of the ongoing construction program and the company's ability to finance that program without inclusion of CWIP in rates. The Commission has recognized the company's exceptional circumstances to assure adequate generating capacity for the future. The company's construction program has not been lightly undertaken, and the Commission sees in the company's effort an unbending commitment toward completion of the projects.

The second and third reasons advanced in support of including CWIP only for licensed and sited plants should be discussed in common as they are to some extent interrelated. The amount of funds required before licensing and siting a project is normally small in comparison to funds required between a project's licensing and its service date. Unavailability of a construction work in progress contribution at crucial early stages of a project's funding, however, risks impediment of the company's capacity to initiate financing and licensing procedures essential for the realization of needed projects. Given that the expenditures for licensing are small in relation to those which may be made after licensing any project, the Commission specifically determines that the added risk to those funds by virtue of their having been expended before licensing is outweighed by the assistance given to the completion of major construction projects.

In summary, the Commission recognizes that continuation of the company's construction program is necessary to assure adequate future generating capacity and that the company's ability to finance its construction program would be endangered absent inclusion of CWIP in authorized rates. Benefits to present ratepayers from inclusion of CWIP include stabilization of Puget's financial circumstances and present service capacity at a time when the company is undertaking a massive construction program to meet future service obligations, and the prospective avoidance of harsh cost increases after various in-service dates, as well as a general overall reduction in post in-service rates from that which could be expected absent present inclusion of

CWIP. By adopting the AFUDC offset method, the Commission has recognized that the present ratepayer should not bear the full financing cost of construction work in progress, but that the cost should be fairly apportioned between present and future ratepayers, inasmuch as the plants in question are not now producing power.

The Commission in prior cases has calculated the spread between construction work in progress and an AFUDC offset as being approximately .78 except in circumstances where an actual smaller AFUDC spread has been demonstrated. An examination of previous Commission treatment of the AFUDC offset reveals some minor variation from the .78 figure. The Commission notes the history of successful ongoing financing with the offset established in this range. In keeping with the determination stated in the Commission's analysis of rate of return (Section IV below) the Commission is increasingly skeptical of the efficacy of this type of calculation when carried to two decimal points. The Commission therefore, for purposes of the present case, will establish a .80 spread between rate of return on CWIP and the offsetting allowance for funds used during construction with the AFUDC rate established at 9 percent, treating the inclusion in the case of the amount determined by the spread as representative of that portion of the rate of return on construction costs which should be allocated to present ratepayers.

The Commission notes and agrees with the contention made by counsel for the public that \$402,000 of the funds allocated for construction work in progress for the Skagit Project are in fact monies devoted to a public informational center at the project site and similar promotional activities, and that such expenditures are not appropriately part of an allowance for construction work in progress, inasmuch as expenditure for these purposes is not essential to financing of the company's ongoing construction program.

F. Rate Base Summary

Table III summarizes the company's 1977 test period rate base calculated in accordance with the Commission's disposition of rate base items considered in this matter.

TABLE III

RATE BASE - PRO FORMA
 AVERAGE OF MONTHLY AVERAGES
 12 Months Ended December 31, 1977

Utility Plant in Service, Plant Held for Future Use,	\$828,008,760
CWIP in Service	
Less:	
Accumulated Provision for Depreciation and Amortization	131,975,285
Accumulated Deferred Income Taxes - Liberalized Depreciation	8,838,000*
Customer Advances for Construction	5,306,741
Rate Base - Actual	681,888,734
3 Restating and 4 Pro Forma Adjustments	(20,113,656)
CWIP Major Projects	89,210,308
Rate Base - Pro Forma	\$750,985,386
End of Period	

152.

SERVICE DATE
JAN 2 1981

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION)	
	)	CAUSE NO. U-80-10
Complainant,)	
)	
vs.)	
	)	FIFTH
PUGET SOUND POWER & LIGHT COMPANY,	)	SUPPLEMENTAL ORDER
)	
Respondent.)	
.....)	

The above-entitled cause involves tariff revisions filed by Puget Sound Power & Light Company, hereinafter referred to as company, Puget, or respondent, by which it proposes to effect a general increase in its rates and charges for electric service furnished within its operating territories in the State of Washington. Hearings on the filing, pursuant to notices given in accordance with requirements of Title 34 RCW, were held at Olympia, Washington, on April 9, 24, and 30; May 5, 9, and 23; July 9, 10, 11, and 15; August 4, 5, 6, and 7; September 29 and 30; October 1 and 2; November 17, 18, 20, and 21; and December 10, 1980 before Chairman Robert C. Bailey, Commissioner Frank W. Foley, Commissioner A. J. Benedetti, and Administrative Law Judge William Metcalf. Hearings to receive testimony from members of the public were also heard on October 9, 1980, at Auburn and on October 10, 1980, at Bellingham before the Commission and Administrative Law Judge Alice L. Haenle; and also at Olympia on May 7 and October 8, 1980, and at Mount Vernon on May 5, 1980, before the Commission and Administrative Law Judge William Metcalf.

The parties were represented as follows:

COMPLAINANT: WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION
By James R. Cunningham
and Douglas N. Owens
Assistant Attorneys General
Temple of Justice
Olympia, Washington 98504

RESPONDENT: PUGET SOUND POWER & LIGHT COMPANY
By William S. Weaver
and Douglas S. Little
Attorneys at Law
1900 Washington Building
Seattle, Washington 98101

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The following findings of fact are made on the oral and documentary evidence of these witnesses.

II. RESPONDENT'S FINANCIAL CONDITION

The essentials of Puget's present financial difficulties are largely uncontroverted; even counsel for the staff concedes that the conclusions of the staff's rate of return expert are unrealistic in light of the evidence of record of need for a rate increase. Parties, however, disagree on the appropriate solutions for the difficulties. The record establishes the following basic situation in which Puget finds itself.

The company's presently authorized return on common equity is 13 percent; its actual return for the test year was 9 percent. The company is faced with one of the largest construction programs, proportionate to its size, of any electric utility in the United States. At present it is carrying 274 million dollars in its construction work in progress (CWIP) accounts.

Although electric utility companies by average industry standards finance 40 percent to 50 percent of their construction requirements with internally generated cash, the company financed all of its construction projects in 1979 by borrowing money. The record shows that respondent had no earnings in that year to apply to construction. In 1980, 40 percent of the company's net income was from the non-cash accounting treatment of allowance for funds used during construction (AFUDC). Respondent contends with recognition of its current construction program, with AFUDC offset, 90 percent of the company's net income in 1981 will consist of non-cash AFUDC.

The company's earnings per share of common stock for the 12 months ended September 30, 1980, were \$1.25 compared to its annual dividend of \$1.64. In 1980, the company represents that it was necessary to utilize borrowed funds to maintain its current dividend level.

The record indicates the company's ratio of CWIP to net plant as of 1980 is 24 percent. By 1984, respondent estimates that it will increase to 38.8 percent.

The company must be able to show certain "coverage ratios" in order to issue preferred stock and first mortgage bonds in amounts to finance its ongoing and planned construction program. A corporation's earnings must cover dividends if its stock is to be attractive to investors.

III. RATE BASE

The ultimate question in this proceeding is whether the rates and charges named in respondent's suspended tariff filings are fair, just and reasonable. The resolution of this question depends on establishing the proper rate of return respondent is to be allowed on the fair value of its property, or rate base. In determining fair value of rate base the Commission has historically accepted the average net original cost theory of rate base measurement made during an actual operating period, comparing it with the results of operations that have actually occurred during that period, after appropriate restatement.

CAUSE NO. U-80-10

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In addition to the historical treatment of rate base as consisting only of plant actually in service, the Commission has in several proceedings in the past five years allowed the costs of certain facilities in the progress of being constructed to be included in rate base. The rationale for this treatment is stated at length in the Second Supplemental Order in Cause No. U-78-21, the last general rate case dealing with the respondent here and as subsequently described in detail under Section A, below.

The testimony and exhibits of respondent reflect calendar year 1979 data. Both respondent and staff used actual results of operations for the 12 months ending December 31, 1979 in presenting their testimony and exhibits. With the limited exception to which reference will be made hereafter, there is no controversy on this point.

Parties are agreed that actual rate base, using average of monthly average account balances, for the test year 1979, is \$789,353,444.

The company and the staff propose a number of adjustments to actual rate base. There are restating adjustments, made to adjust the rate base per books so that the test year reflects only those items that properly belong in the test period, and pro forma adjustments, which give effect to all known changes which can reasonably be measured are stated as though such changes had been in effect for the entire test year, to the extent not offset by other factors. The actual rate base and adjustments are shown as follows:

RATE BASE-ACTUAL and PRO FORMA (Avg. of Mo. Avg.)

Calendar Year 1979

	<u>Company</u>	<u>Staff</u>	<u>Staff Greater</u>
Rate Base-Actual	\$ 789,353,444	\$ 789,353,444	\$ -
3 Uncontested Adjustments	(987,570)	(987,570)	-
Contested Adjustments			
RA-5 CWIP Overhead	-	(693,139)	(693,139)
RA-6 Property Held for Future Use	-	(1,271,963)	(1,271,963)
P-16 Colstrip Houses	-	(136,789)	(136,789)
P-17 Production Adjustment	(16,943,228)	(16,942,958)	270
P-18 CWIP in Rate Base	48,492,624	237,095,975	188,603,351
Weatherization Program	(1,006,029)	-	1,006,029
Rate Base-Pro Forma	\$ 818,909,241	\$1,006,417,000	\$187,507,759
Weatherization Program-Alternative	8,960,506	-	(8,960,506)
Rate Base-Pro Forma-Alternative	\$ 827,869,747	\$1,006,417,000	\$178,547,253

Staff and company agree to a restatement of the Tree Trimming account that reduces rate base in the amount of \$415,228 because the account was incorrectly capitalized rather than expensed in 1978. Parties also agreed to pro forma adjustments for depreciation expense (\$284,342) and Colstrip CWIP (\$288,000).

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It should be noted that while the amount of the adjustment applicable to Colstrip CWIP (\$288,000) is not in dispute, the company contends such amount should be placed in Account 105, property held for future use, while staff contends such amount is properly includable in CWIP. We agree with staff that since the land in question is part of a project currently under construction, its cost is appropriately part of the construction cost and should be included in CWIP. The three adjustments reduce actual rate base by \$987,570. Elements of rate base which are disputed will be discussed next, beginning with additions to rate base.

A. Construction Work in Progress (CWIP)

Consistent with past construction work in progress treatment by the Commission, the company proposes to include \$48,492,624 of CWIP in rate base during the test period. This amount, however, does not include all major production and associated transmission projects but has been limited by the company to the two major construction projects involving the Satsop Nuclear Plant (WPPSS #3) and Colstrip coal-fired Units #3 and #4, that have all necessary permits and are in the construction stages.

As an integral part of its request for the inclusion in rate base of the two major projects indicated, the company also requested that no AFUDC offset be made to net operating income as has been the Commission's policy in past proceedings. Reasons stated by respondent for the inclusion of CWIP in rate base with no AFUDC offset include an increase in internal cash flow of the company, improve coverage requirements in future financing, reduce the AFUDC amount carried in the company's income statement and generally improve the quality of its earnings.

Staff presentation initially recognized the two major projects for inclusion in rate base but calculated an associated AFUDC offset in operations. As the proceeding progressed, the staff at time of oral argument and brief recognized the magnitude of respondent's immediate financial needs as shown in this record, and proposed to adjust rate base to show all test year CWIP with total test year AFUDC as the applicable offset.

In Cause No. U-75-24, involving Pacific Power & Light Company, the Commission first departed from a long-standing policy of not allowing the cost of incompleting construction to be included in rate base for ratemaking purposes and included the costs of major production and related transmission facilities with a corresponding AFUDC offset added back to operations. Primary among the reasons stated for such departure was the dramatic increase in CWIP as a percentage of net plant. The Commission noted in its reappraisal process for CWIP treatment in that proceeding that staff analysis did not show for telephone and gas utilities a similar need for improvement in cash flow requirements. It was the Commission's opinion at that time that the assessment of a portion of the future service cost to present users was equitable and necessary; that the addition of CWIP to rate base would add after taxes that level of earnings below which AFUDC had failed to yield the return on production and related transmission CWIP determined by the Commission as necessary to maintain adequate credit; and further, that the revised policy then implemented did not constitute a persuasive precedent in cases other than those involving electric utilities and then only as to those electric cases wherein CWIP is shown

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to represent a dramatic, increasing percentage of net utility plant.

In all electric rate proceedings since its decision in Cause No. U-75-24, the Commission has accorded CWIP treatment to rate base with the customary AFUDC offset. In the instant case, respondent seeks CWIP inclusion but no AFUDC offset. In the immediately preceding general rate case involving this company, Cause No. U-78-21, the company similarly requested a CWIP inclusion in rate base with no AFUDC offset. The Commission found in that proceeding that an effective increase in CWIP over the amount the Commission has heretofore authorized could not be permitted absent a showing that included as one element a demonstration that the company could not finance its construction program under the method previously adopted by the Commission.

In its rebuttal case in the instant proceeding, the company contends that retention of the present method of allocating CWIP would prohibit the company from not only earning a fair rate of return but would prevent the company from meeting the necessary coverage tests for future debt and preferred equity financings.

The attitude of the Commission in this proceeding remains unchanged from that stated in its order in Cause No. U-78-21----

"the continuation of the construction program and the company's ability to finance that program, including its ability to maintain debt coverages, reflect generally on the company's ability to finance for present as well as for future customers.

It is not arguable that plant in service is a more reliable object of funding than is a plant under construction, and service from projects under construction cannot now be flatly guaranteed. However, the likelihood of a needed project's being timely completed is influenced by a utility's ability to raise capital for the project and by a regulatory body's creating a climate which is not inhospitable to the funding of such necessary construction----

Respondent's present financial needs are no less critical now than they were two years ago. The record in this proceeding shows that the company's financial position currently is in a state of deterioration which requires significant and immediate relief. It is obvious that continued application of the AFUDC offset will not provide the necessary internal cash earnings to permit the company to meet its necessary construction requirements as well as its several coverage tests.

After careful consideration of all the facts on this record and for the reasons stated hereinabove, it is the conclusion of the Commission that a portion of CWIP should be included in rate base with no AFUDC offset. In recognition of Puget's particular financial needs, 20 percent of total test year CWIP is determined as an appropriate amount allowable in rate base without the recommended AFUDC offset. The Commission policy adopted in this case is not necessarily intended as a precedent for future cases of this company or other utilities, but does represent in the Commission's judgment an action deemed necessary in responsibly meeting the obligations of this Commission to regulate the company in the public interest. The solution adopted herein is based upon the showing of a critical need for cash and total construction

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work in progress amounting to more than 20 percent of total net utility plant. The applicable allowance so determined herein is \$47,419,195.

B. Weatherization.

The company asks that its rate base not reflect investments in its weatherization program, the program approved in Cause No. U-78-45. The company proposes to treat weatherization investment and expenses in a separate proceeding. As an alternative the company asks that all weatherization investment and expenses through September 1980 be included. The staff contends that only test period weatherization expenses should be recognized here because the matching revenues, power costs, and load requirements cannot be identified beyond the test period and that consequently a correct pro forma adjustment cannot be made for this item. However, in the weatherization proceeding the Commission stated that all the company's unamortized operating expenses applicable to the program which are charged to Account 186 also will be included in its rate base for ratemaking purposes.

To include all the company's unamortized operating costs applicable to the weatherization program in rate base will provide the company with an incentive to expand its weatherization program. Expansion of the program will provide immediate conservation savings to the benefit of the company and its customers on a favorable cost to benefit ratio and thereby serve to decelerate the need for more costly construction projects. Accordingly, the company's evidence of weatherization costs through September 30, 1980 (a total of \$8,960,506) will be accepted in establishing the adjusted rate base for purposes of the present proceeding. Already included in the agreed rate base is \$1,006,029 for this item; the adjustment found proper here will recognize the additional costs.

C. Production Adjustment.

The staff's production adjustment reducing plant in service during the test period to reflect the production percentage factor to which Mr. Knight and Mr. Hess agree, is consistent with evidence of record. Exhibit No. 114 corrects Mr. Hess' original power supply calculation as a result of the load restriction case, Cause U-80-77. The record shows that the company and the staff are in substantial agreement on this adjustment. The correct net figure to be removed from rate base is \$16,943,228.

D. Cherry Point Property.

Respondent owns vacant land at Cherry Point and has since 1968 been carrying it in Account 105, Property Held for Future Use, at a value of \$1,271,963. Staff proposes removing this amount from rate base because the property is not being "held for future use in utility service under a definite plan for future use" as required by WAC 480-100-031 for Account 105.

Testimony indicates that the company is making feasibility studies for future use of the property for utility service, but testimony also establishes that the plans for its future use are general in nature. However, there is testimony indicating that the property does have a good potential for a future generating site, and the company will be allowed to reflect the booked amount in the rate base in this proceeding. In future proceedings the

SERVICE DATE 1.
NOV 19 1980

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION,)	
	)	CAUSE NO. U-80-25
Complainant,)	
	)	CAUSE NO. U-80-27
vs.)	
)	
WASHINGTON NATURAL GAS COMPANY,	)	FOURTH SUPPLEMENTAL ORDER
)	
Respondent.)	
.....)	

This matter came on regularly for hearing on April 25, June 3, July 16 and 17, September 23, and October 2 and 28, 1980 in Olympia, Washington, and also on October 3, 1980 in Seattle, Washington pursuant to notice duly given. The hearings were held before Chairman Robert C. Bailey, Commissioner Frank W. Foley, Commissioner A. J. Benedetti, and Administrative Law Judge Pauline C. Nightingale.

The parties were represented as follows:

- COMPLAINANT: WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION
By Robert E. Simpson and
Donald T. Trotter
Assistant Attorneys General
Temple of Justice
Olympia, Washington 98504
- RESPONDENT: WASHINGTON NATURAL GAS COMPANY
By J. Jeffrey Dudley and
Marion V. Larson
Attorneys at Law
1300 IBM Building
Seattle, Washington 98101
- INTERVENOR: SEATTLE CONSUMER ACTION NETWORK
By Craig Salins, Coordinator
and Ed Zuckerman
312 Lowman Building
Seattle, Washington 98104
- PUBLIC: PEOPLE OF THE STATE OF WASHINGTON
By Fred R. Butterworth and
Laurence R. Weatherly
Special Assistant Attorneys General
1220 IBM Building
Seattle, Washington 98101

History of Case.

On February 29, 1980 respondent Washington Natural Gas Company, a public service company engaged in furnishing gas service within the State of Washington, filed a revision to its

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TABLE I
 WASHINGTON NATURAL GAS COMPANY
 RATE BASE-ACTUAL AND PRO FORMA
 Calendar Year 1979
 (\$000 Omitted)

	<u>Company</u> End of Period	<u>Staff</u> Avg. of Mo. Avg.
Utility Plant in Service	\$240,113	\$229,023
Completed Work Not Classified	9,388	8,217
Gas Stored Underground-Nonrecurrent	3,848	3,081
Less:		
Accumulated Provision for Depreciation	53,395	50,894
Contributions for Construction	1,580	1,546
Deferred Federal Income Taxes - Liberalized Depreciation	8,438	8,438 (1)
Add:		
Allowance for Working Capital	<u>6,168</u>	<u>2,593</u>
Rate Base-Actual	\$196,104	\$182,036
Adjustments		
Merchandising and Jobbing	(227)	(227)
Jackson Prairie	(479)	(491)
Inter Company Services	(36)	(36)
Reclassify AFUDC, Etc.	(481)	(406)
Miscellaneous Adjustments	-	3
Adjust Income Tax	14	14
Working Capital	<u>1,679</u>	<u>(16)</u>
Rate Base-Pro Forma	<u>\$196,574</u>	<u>\$180,877</u>

(1) End of Period

Respondent urges use of end-of-period rate base as a means of improving the company's prospects for earning its allowed rate of return. The company claims that since 1972 its revenues have remained consistently below levels allowed by the Commission in the seven rate orders which were issued during that period and which authorized successive increases in rate of return on average-of-monthly averages rate base.

Respondent attributes a utility's failure to achieve authorized return on average rate base to attrition, or the decline in rate of return which occurs during periods when costs of plant and operation rise more rapidly than the revenues generated by those costs. Respondent contends that ratemaking predicated on a year-end rate base mitigates attrition because year-end data more closely approximates post-rate-case conditions.

Respondent's exhibit 2, a graph introduced to prove attrition, shows continuous disparity between the company's authorized and actual rates of return between 1972 and the end of 1979. The data used in the exhibit are from the company's books without adjustment to revenue for weather, lobbying expense, organizational dues, or expenses chargeable to merchandising and jobbing operations, and without adjustment to rate base for items allocable to affiliated companies. Consequently, exhibit 2 does not reflect earnings or rate base calculated according to the methods prescribed in the rate orders governing the period surveyed and

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CAUSE NOS. U-80-25 and U-80-27

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is insufficient to establish the extent, if any, of attrition experienced in the company's regulated operations.

Staff opposes the end-of-period approach on the ground that the fluctuations characteristic of sources of revenue and expenses preclude a proper matching of recorded revenues and expenses at a single point in time. Staff is also critical of respondent's pro forma adjustments to year-end customer levels because estimates were used in the process of adjusting.

Absent extraordinary circumstances, test-period average rate base is representative of the investment associated with the revenues and expenses reflected in test-period operating results. Point-in-time rate base is not as susceptible to reliable comparison with results of an operating period. Portrayal of revenues and expenses as of a point in time for comparison with investment fosters overstatement or understatement of revenue requirement, depending on variables such as customer level at the point in time selected. Distortion of revenue requirement in either direction leads to results which are contrary to the statutory requirement that rates be just, reasonable and sufficient.

The Commission continues to be concerned about the need of utilities to deal with regulatory lag and inflation; however, if attrition has in fact eroded respondent's rate of return, the validity of the end-of-period approach as a solution is not demonstrated in this record. The Commission will be receptive in dealing with future cases to well-reasoned, supportable mechanisms to address these concerns, recognizing that adoption of such mechanisms would require verifiable evidence of their validity and propriety.

Respondent's analysis of working capital allowance is in part derived from a study of the lag time between its delivery of service to the customer and its receipt of revenue therefor, offset by the lead time between the company's receipt of goods and services from vendors and employees and its payment therefor. The net lag time determined from the study was compared to pro forma revenue requirement to yield the capital required to finance net lag in recovery of costs of providing service. To that component of working capital was added test year investment in materials, supplies, gas inventories and compensating balances required under short-term borrowings, less deferred taxes on unbilled revenues, to arrive at total working capital included in rate base.

Staff prepared its determination of investor-supplied working capital from balance sheet accounts, less compensating balances.

Staff objects to the lead-lag method principally on time and accuracy considerations. Between 700 and 800 hours were spent developing the lead-lag study. Staff spent in excess of 100 hours checking the study, which consisted of more than 100 pages. Respondent contends that the same study can be applied in future cases with revision only for changes of circumstances.

The challenge to accuracy of the study is directed at respondent's random sample of 150 out of 25,000 total test-year vouchers to calculate average lead days for the voucher payment category of operating expenses. The sample was not tested for statistical validity. Based on a check of the voucher study and

SERVICE DATE 335.
SEP 24 1981

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND)	
TRANSPORTATION COMMISSION,)	
	)	CAUSE NO. U-80-111
Complainant,)	
	)	THIRD SUPPLEMENTAL ORDER
vs.	)	FINDINGS OF FACT
	)	CONCLUSIONS OF LAW
WASHINGTON NATURAL GAS	)	AND COMMISSION ORDER
COMPANY,)	
)	
Respondent.)	
.....)	

This matter came on regularly for hearing on January 23, February 13 and 18, April 7 and 14, May 5 and 6, June 29 and August 19, 1981, at Olympia, Washington, and on February 20 and June 30, 1981, at Seattle, Washington, before Chairman Robert W. Bratton, Commissioner Robert C. Bailey, Commissioner A. J. Benedetti, and Administrative Law Judge Clarence M. George. At the request of the company the presentation of the company's rebuttal testimony was continued until August 19, 1981.

The parties were represented as follows:

COMPLAINANT: WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION
By Robert E. Simpson
and Donald T. Trotter
Assistant Attorneys General
Temple of Justice
Olympia, Washington 98504

RESPONDENT: WASHINGTON NATURAL GAS COMPANY
By J. Jeffrey Dudley
and Marion V. Larson
Attorneys at Law
1300 IBM Buidling
Seattle, Washington 98101

PUBLIC PEOPLE OF THE STATE OF WASHINGTON
By Jeffrey O. C. Lane
Special Assistant Attorney General
5th Floor Highways-Licenses Bldg.
Olympia, Washington 98504

I. HISTORY OF PROCEEDINGS

The respondent Washington Natural Gas Company (hereinafter referred to as company, WNG, and/or respondent) on December 22, 1980, filed certain tariff revisions which are designed to effect a general increase in its rates and charges for natural gas service within the State of Washington in the approximate amount of \$23,836,000. On rebuttal respondent reduced its request for a general rate increase to \$21,763,000.

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A. AVERAGE VS. YEAR-END RATE BASE

The appropriate rate base, that is year-end or average of monthly averages, has long been a contention between the staff of this Commission and the utilities regulated under our jurisdiction. The staff has without exception held to the position that in order to accurately measure revenues and expenses during a test year the properties that produce those revenues and cause the expenses must be matched as the revenues are generated and the expenses incurred. Otherwise a "mismatch" of revenue and expenses will result.

The companies on the other hand have contended that a year-end rate base more accurately approximates the company's investment during the time the rates are in effect.

Continuous arguments persist in the halls of regulatory commissions throughout the country concerning the merits of these two approaches to rate base. This Commission has historically sided with the proponents of the average rate base. We have in the past decade witnessed a proliferation of rate filings and most filings have brought the differences over rate base into sharp focus.

It is not a misstatement to say that the weight of authority, both in the administrative and judicial branches, favors average over year-end rate base on the premise that in normal economic times average rate base is more realistic and projects more accurately the cost of plant that produces the revenue under investigation. However, there is sizeable and well-recognized authority that in an abnormal and less stable economic climate year-end rate base may be more appropriate and should be used to balance out the financial problems caused by abnormal and uncertain economy.

We have been furnished with exhaustive briefs by counsel for the company and the assistant attorney general representing the Commission in this matter, which have been very helpful to the Commission.

As far back as 1973 this Commission recognized that as a matter of regulatory principle, our utilization of average rate base was not cast in stone. In Cause No. U-72-33t, we stated:

Notwithstanding the adoption of the average rate base in this cause, we do not intend the conclusions reached should be interpreted as our final view on this subject so as not to leave room under proper circumstances and facts to adopt the end of period rate base in some future case.

In 1974 in Cause No. U-73-57 WUTC complainant vs. Puget Sound Power & Light Company, respondent, 6th Supplemental Order dated October 25, 1974, we reiterated those sentiments and observed:

Historically, the Commission has accepted the average rate base concept as being an appropriate tool in the measurement of earning levels. It has not, however, discounted the validity of year-end rate base where special conditions exist, such as unusual growth in plant at a faster pace than customer growth and customer rate-making treatment is deficient.

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In Cause No. U-80-25-27, WUTC vs. Washington Natural Gas Company, 4th Supplemental Order dated November 19, 1980, we stated:

The Commission continues to be concerned about the need of utilities to deal with regulatory lag and inflation. However, if attrition has in fact eroded respondent's rate of return the validity of the end-of-period approach as a solution is not demonstrated in this record. The Commission will be receptive in dealing with future cases to well reasoned supportable mechanisms to address these concerns, recognizing that adoption of such mechanism would require verifiable evidence of their validity and propriety.

From the authority cited on brief we can draw the following conclusions:

- (1) Average rate base is the most favored,
- (2) Year-end rate base is an appropriate regulatory tool under one or more of the following conditions:
 - (a) Abnormal growth in plant
 - (b) Inflation and/or attrition
 - (c) As a means to mitigate regulatory lag
 - (d) Failure of utility to earn its authorized rate of return over a historical period

It is recognized that inflation is having a deleterious effect on the economy in general and particularly on public utilities requiring large amounts of new capital to meet demands of their respective service areas. We must also recognize that regulatory lag (the interim period elapsing between the filing of a rate case and its ultimate disposition) has long been a concern of both the utilities and their regulators, and regulatory lag may tend to erode the earnings of a utility. If regulatory lag has a deleterious effect, it is difficult to compensate for its overall adverse effect. However, as regulators we have the responsibility to mitigate that effect to the extent possible.

The respondent is experiencing a phenomenon that is related to demands for new plant. The respondent contends that notwithstanding the additions of new plant and customers in its service area the revenue produced by additions has not paralleled the capacity and utilization of new plant. This is demonstrated by the fact that the company has experienced a sizeable increase in residential customers during the test year over the immediate preceding year, but the delivered therms to residential customers during the test year is less than that delivered during the preceding year. This condition has been caused in part by the serious and conscientious efforts of the public to conserve energy. The company has also experienced a considerable decline in its interruptible gas deliveries due to escalating cost of natural gas in relation to other sources of fuel, and has not realized its authorized rate of return for the past several years.

CAUSE NO. U-80-111

Page 7 341.

We are convinced that the unusual circumstances referred to in Cause Nos. U-72-30tr, U-73-57 and U-80-25-27, supra, are present in the instant case to warrant the adoption of an end-of-period rate base, provided the company meets the burden of reasonably matching revenue and expenses to year-end rate base.

The company recognizing that it has the burden to meet the fundamental and legitimate objections to adoption of an end-of-period rate base, submitted evidence that essentially adjusted year-end employees and associated expenses, year-end customers and pro forma year-end revenues, all as of September 30, 1980, the last day of the test period.

The staff challenges the validity of respondent's study contending that the conclusions drawn from the company's evidence actually distorts reality. The staff contends that the point in time selected by the company understates customers and revenues and overstates employees. Even though staff Exhibit No. 76 tends to support its conclusions, the evidence used to match revenues and expenses must be reasonable and not necessarily absolute. By definition year-end rate base requires a spot date to examine the revenues and expenses. This is what the company has done and that is what we require.

It might be said that the company's study is not sufficiently detailed and lacks a degree of sophistication that can otherwise be obtained. However, the lack of detail and sophistication goes more to the weight of the evidence than to its credibility. We are satisfied that the company has met the burden of proof. We are convinced that the company study is sufficiently reliable for us to base a reasonable and informed judgment.

The year-end rate base will be adopted for ratemaking purposes in this proceeding. We will continue, however, to require the company to submit its monthly financial and operating data on the basis presently in use for reporting purposes but will also permit similar results to be reported that have been recast for year-end adjustments.

We recognize the adoption of a year-end rate base associates with the highly inflationary circumstances and service use decline being experienced by respondent. We do not foreclose a return to an average rate base as being representative in a more stable economy.

B. ALLOWANCE FOR WORKING CAPITAL

The company and the staff, except for Allowance for Investor-Supplied Working Capital, agree to the components of the rate base. The major dispute between the staff and company in determining their proper rate base relates to the treatment of allowance for Investor-Supplied Working Capital.

The fundamental difference between the staff and company in calculating investor-supplied working capital is due to the following:

- (1) The company includes in its invested capital compensating balances in the sum of \$3,392,000 related to its short-term loans. The staff deducts the compensating balances.
- (2) The company in calculating its net non-operating investment:

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BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION,)	
)	
Complainant,	)	CAUSE NO. U-81-15
	)	(Electric)
vs.)	
)	
THE WASHINGTON WATER POWER COMPANY,)	
)	
Respondent.)	
.....)	
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION,)	
)	
Complainant,	)	CAUSE NO. U-81-16
	)	(Gas)
vs.)	
)	
THE WASHINGTON WATER POWER COMPANY,	)	SECOND
	)	SUPPLEMENTAL ORDER
Respondent.)	
.....)	

The Washington Water Power Company, on March 6, 1981, filed certain tariff revisions which are designed to effect a general increase in its rates and charges for electric service (Cause No. U-81-15) and for natural gas service (Cause No. U-81-16) rendered in the State of Washington.

The above-entitled cause numbers came on regularly for hearing upon proper notice at Olympia, Washington, on May 14, July 7 and 8, August 11 and 12, September 22, and October 13, 1981; at Clarkston, Washington, on September 28; and at Spokane, Washington, on September 28 and 29, 1981, before Chairman Robert W. Bratton, Commissioner Robert C. Bailey, Commissioner A. J. Benedetti and Administrative Law Judge Clarence M. George.

The parties were represented as follows:

COMPLAINANT: WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION
By Robert E. Simpson
and Donald T. Trotter
Assistant Attorneys General
Temple of Justice
Olympia, Washington 98504

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- (1) Identification and determination of an appropriate test period to evaluate the company's operations for the purpose of determining proper rates and charges.
- (2) Identification and evaluation of an appropriate rate base.
- (3) Determination of an appropriate rate of return the utility is entitled to earn on the rate base found by the Commission.
- (4) An analysis of the company's results of operations during the appropriate test year with adjustments for unusual events during that period and for known and measurable events following the test period.
- (5) Determination of any existing revenue deficiency.
- (6) Allocation or spreading of rate increases fairly and equitably among the company's ratepayers.

III. TEST YEAR

The company for its test period (electric) presented operations based upon a projected results of operations for the year ending December 31, 1981. The company contends that a test period based upon a carefully scrutinized budget sufficiently represents the period to be covered by the new rates to provide a reliable guide for ratemaking purposes.

The company's witness Fukai, stated that the reason the company departed from the traditional use of a historical test year is because ratemaking should properly be directed toward setting rates at a level that will provide sufficient revenues during the period when those rates are actually in effect. The witness contends that the use of a historical test period incorrectly assumes that the result of a past test period are sufficiently representative of the period covered by the new rates so as to provide a reliable guide for ratemaking, particularly during periods of extraordinary expenditures coupled with uncertain economic conditions characterized by high levels of inflation. The witness states that the historic test period fails to reflect and to take into consideration the erosion in the company's earnings caused by attrition. To compensate for the attrition factor, the company applied as an adjustment an inflation factor of 8% to certain unspecified expenses.

The staff and the intervenor POWER and counsel for the public jointly argue against the adoption of a test year based upon a projected budget contending that:

- (1) Forecasted data do not provide reliable testing or analysis;

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- (2) The use of forecasts effectively prohibits the Commission from exercising its judgment; and
- (3) Forecasts tend to be self-fulfilling prophecies.

The staff for the purpose of examining the company's electric operation used the traditional test year approach, that is the calendar year 1980.

Staff on brief argues that a historical test year reflects the actual expenses of the utility. Staff further argues that a historical test year is more comprehensive and conducive to accurately determining what adjustments are necessary to reflect the company's future revenue requirements.

Traditionally, this Commission has adopted the historical test year to examine a utility's operating results. We are not at this time prepared to depart from that posture for a variety of reasons, including the inability of the company in this proceeding to demonstrate that the projected budget test year is reliable and reasonably subject to intelligent examination and scrutiny upon which we can base an informed judgment. This is clearly demonstrated by the results of the cross-examination of witness Fukai. He candidly admitted that upwards of 100 people are involved in the company's budgeting process and the budget includes estimations and assumptions that may or may not materialize during the period the rates are in effect. Accordingly, we will adopt the calendar year 1980 for the purpose of examining the company's electric operations.

IV. RATE BASE

Because we have rejected the company's projected test year and adopted the calendar year 1980 as the proper test year to examine the company's operations, our determination of the company's appropriate rate base for the purpose of this proceeding must necessarily be determined from the presentation made by the staff because that is the only portrayal of rate base made for the test year we have adopted.

Staff's second revision to Exhibit No. 32, Page 18, is the response the company made to staff's request to calculate the company's rate base for the calendar year 1980 on the average of monthly averages method including restated and pro forma adjustments. The staff's portrayal of the average of monthly averages rate base for the same period differs from that furnished by the company and is set forth in Exhibit No. 58, Page 1.

Below are summaries of the company's projected rate base, the rate base set forth in Second Revision to Exhibit No. 32, Page 1, and the staff's ultimate submission of its rate base portrayal as set forth in Exhibit No. 58, Page 1. For the purpose of determining the proper rate base in this proceeding, we will only refer to and consider the differences in rate base, portrayed by Exhibit No. 32, Page 1, and Exhibit No. 58, Page 1.

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RATE BASE - ACTUAL & ADJUSTED
 WASHINGTON ELECTRIC OPERATIONS

(\$000 Omitted)

	<u>Company</u>		<u>Staff</u>	<u>Staff (Less)</u>	
	Projected 12-31-81 (Exh. #9) (1)	Avg. of Mo. Avg. 12-31-80 (Exh. #32) 2nd Revised) (2)	Avg. of Mo. Avg. 12-31-80 (Exh. #58, T-67, T-70) (3)	Col. (3) vs. Col. (1) (4)	Col. (3) vs. Col. (2) (5)
Rate Base - Actual	\$ -	\$250,788	\$250,788	\$ -	\$ -
Uncontested Adjustments	-	1,100	1,100	-	-
Contested Adjustments					
CWIP	-	48,427	15,627	-	(32,800)
Non-Revenue Rate Base	-	1,552	1,550	-	(2)
Accumulated Qualified Progress Expenditure 4% ITC	-	-	(988)	-	(988)
Rate Base - Adjusted	<u>\$320,360¹</u>	<u>\$301,867</u>	<u>\$268,077</u>	<u>\$(52,283)</u>	<u>\$(33,790)</u>

Company Proposal

A. Construction Work in Progress (CWIP)

The company includes \$48,427,000 of CWIP as an addition to rate base. The company's calculation of this adjustment is to reflect in its rate base 50% of its projected 1981 year-end CWIP relating to WPPSS No. 3 and Colstrip Units No. 3 and 4.

The staff proposes that the company's rate base include 100% of its CWIP invested in Colstrip No. 3 and 4 with no AFUDC offset, and that all other CWIP be excluded from the rate base with the company accruing allowance for funds used during construction (AFUDC) on that CWIP compounded annually at a rate equal to the fair rate of return. The staff's proposal resulted in an addition to rate base in the sum of \$15,627,000.

Intervenor POWER on brief raises several questions concerning the propriety of including any CWIP in the company's rate base. This Commission has over the past several years considered the arguments advanced by counsel. We have determined that the propriety of including CWIP in rate base is a matter that lies within the discretion of the Commission and is to be determined on a case-by-case basis. In effect POWER argues that RCW 80.04.250 forecloses the Commission from including any property

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of a regulated utility in rate base for ratemaking purposes until that property either is capable of or actively rendering service to the customers of the utility. We are of the opinion that counsel's argument is not a valid interpretation of the statute and is without merit. See State ex rel. Pacific Telephone & Telegraph Company vs. Department of Public Service, 19 Wn.2d 200, 142 P.2d 498 (1943) wherein the court held that property held by a regulated utility for future use could properly be included in the company's rate base for ratemaking purposes.

Both Mr. Harning and Mr. Louiselle agree that the magnitude of the company's construction program including the three major projects when completed in approximately 1986 will equal the company's December 31, 1980 plant in service and is having a direct adverse impact on the company's earnings, interest coverage and cash flow to the extent that the company's ability to raise funds from external sources at reasonable costs is in jeopardy. Both witnesses agree that the company will not be able to overcome these adverse financial impacts caused by its construction program without recognition of CWIP in rate base. An inclusion of CWIP in rate base will have a direct benefit to the company and consequently to the ratepayer.

Mr. Harning studied three methods for treating CWIP and the consequences of each in terms of revenue collected. The witness readily stated that each method will impact both the company and the ratepayer.

The three approaches that he testified to are:

(1) The method whereby no CWIP is included in rate base and AFUDC is continuously capitalized until the project is completed. He concluded that this method in the long term will require the highest amount of revenues from the ratepayer to enable the company to recover the financing charges associated with the construction of the three major projects. He estimated that the revenue required over the life of the plants for the company to recover only the financing charges will be approximately \$464,383,000. He also maintained that the study shows that under this method the company cannot fully recover its financing charges unless the AFUDC rate is compounded semi-annually. He further maintained under this method that the ratepayer receives benefits because of flowing through the federal income tax reduction related to the interest portion of AFUDC. He estimated this benefit to total \$85,977,000 during the construction period. This he maintains will result in a substantial negative impact on the company's cash flow and adversely affect the ability of the company to generate internal funds for construction projects.

(2) The second method is to annually include CWIP in rate base each December 31, with AFUDC continuing until the effective date of any future proposed rate changes.

(3) The third method is to include all CWIP in rate base without AFUDC capitalization. (In the company's latest general rate case in Cause No. U-80-13, we allowed a portion of the company's CWIP in rate base without an AFUDC offset.)

The witness concluded that his studies (Exhibit Nos. 16 and 17), conclusively demonstrate that the optimum method is

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to include the company's total CWIP in rate base. He draws this conclusion from the following: under methods (1) and (2) the company will eventually recover and be fully compensated for the cost of financing its construction project (See Exhibit No. 16, Pages 5 and 6). Under method (3), the company will be able to immediately improve its cash flow because it will be receiving revenues currently rather than when the plant is placed in service. The quality of the company's earnings will be improved resulting in an improvement to its interest coverage and will reduce financing requirements, and these benefits to the company over the long run will inure to the ratepayer. He further observed the ratepayer over the long term will experience a gradual increase in its rates attributable to CWIP rather than a large sudden increase in rates when the plants are completed.

In addition to the studies concerning CWIP, the witness at the company's request conducted a study of customer migration and usage patterns (Exhibit No. 18). We will not herein detail this study except to observe that the witness concluded:

- (1) That present customers between the period 1980-1986 will account for 23% of the growth anticipated in total residential energy sales;
- (2) Eighty-eight percent of the present customers can be expected to be customers through 1986; and
- (3) That as customers move from one location to another within the service area their energy requirements increase at the approximate rate of 17% due partly to the increased use of space heating as well as a higher standard of living.

Mr. Louiselle testified that if the company is allowed to include CWIP related to the Colstrip plants only, this would meet the company's financial challenge caused by new plant not yet in service, and lessen the financial impact that ongoing cost of new plant has on the financial integrity of the company, and would enable the company to finance its construction program on reasonable terms, and in the long run would alleviate the harsh effect the future customers would experience if CWIP in rate base is not allowed on a gradual basis.

Mr. Louiselle explained that the reason he recommends CWIP without AFUDC accounting for the Colstrip units only, and AFUDC accounting on all other projects under construction, is because those units are expected to go into operation in 1985, where there is uncertainty associated with WPPSS Plant No. 3 and the continuation at another site of the Skagit project.

After reviewing all arguments concerning this adjustment, the Commission is convinced because of the magnitude of the company's present and future construction programs, the company will not be able to finance its construction projects on reasonable terms without including a portion of CWIP in rate base. The Commission is of the further opinion that the approach used by Mr. Louiselle is the more practical and reasonable one for

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the Commission to adopt. We are convinced under Mr. Louiselle's recommendation the company will be better able to finance its construction projects on reasonable terms, and will during the period the proposed rates are in effect bolster the company's financial posture and allow it to finance its construction projects on reasonable terms.

In accepting the staff's recommendation on CWIP herein, we direct respondent to follow the implementation procedure set forth in Exhibit T-70, Page 68-69, which may be summarized as follows.

Respondent should not begin accruing AFUDC on the Colstrip CWIP included in rate base herein until its 13-month average Washington investment in Colstrip exceeds \$75.3 million. At that time the company should begin capitalizing AFUDC on only that portion of its Washington Colstrip CWIP that exceeds the \$75.3 million. Further, the Commission will require in future rate proceedings a detailed derivation of all CWIP allocable to Washington retail operations.

At this juncture, it should be pointed out that intrinsically related to Mr. Louiselle's CWIP consideration is his adjustment for attrition which will be discussed in the results of operations section of this order.

What we have said here may seemingly be a departure from our treatment of CWIP in the Third Supplemental Order dated January 26, 1981, Cause No. U-80-13, involving the company's latest general rate relief case wherein we stated a policy favoring allowance of 20% of total CWIP in rate base without AFUDC offset. However, in that case we quoted with approval from our order in Cause No. U-80-10 wherein we stated:

The Commission policy adopted in this case is not necessarily intended as a precedent for future cases of this company or other utilities but does represent in the Commission's judgment an action deemed necessary in responsibly meeting the obligations of this Commission to regulate the company in the public interest. The solution adopted herein is based upon the showing of a critical need for cash and total construction work in progress amounting to more than 20% of total net utility plant.

We hereby affirm the underlying principle quoted above.

The Commission is of the further opinion that we will allow the company to compound AFUDC annually at the fair rate of return, for if we were to do otherwise, the company in effect would be earning on those funds a higher rate of return than its authorized overall rate of return.

B. Qualified Progress Expenditure Investment Tax Credit (QPE)

This adjustment to rate base is to reflect the credit of the 4% of QPE already received by the company for the years 1976-1979 on major projects not yet completed. The company in

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be 15% with the resulting rate of return of 13.66% considered appropriate for use in arriving at the fair amount of coal expenses to be recognized for inclusion in respondent's Washington electric operations. We have restated this adjustment to reflect our conclusions resulting in an increase to the company's NOI of \$253,000.

J. Weatherization Adjustment to Excise Tax

This adjustment prepared by staff only represents the reduction the company is entitled to take from Washington gross excise tax associated with the sale of certain weatherization items. We accept staff's adjustment increasing net operating income by \$4,000.

K. Weatherization Investment

The staff's adjustment of this account accurately reflects the company's entitlement to the benefit of RCW 80.28.025. The company neglected to make provision for this adjustment. We agree with staff's adjustment which has the effect of reducing the company's net operating income in the amount of \$10,000.

L. Attrition Allowance

As stated elsewhere in this order staff witness Louiselle recommended that the company be allowed to include an allowance for attrition adjusted to November 1982. He concludes the attrition allowance will afford the company the reasonable opportunity to earn the allowed rate of return in the first year rates resulting from this proceeding are in effect. The witness readily admitted that judgment is inherent in his analysis from which he draws his recommendations. This analysis is based upon likely or probable changes that can be expected in revenue, expenses and rate base that one can anticipate will occur from the end of the test period at December 31, 1980, to November 30, 1982.

We will not attempt herein to detail his studies and analysis in depth. A brief summary will suffice.

He first analyzed past growth in revenues (excluding growth due to rate increases), expenses and rate base and considered events that are likely to take place in the future which would affect the company's operation one year after the instant rate increases become effective. The revenue analysis is based upon growth in sales which is found to average 5.6% per year between 1974 and 1980. For the purpose of attrition allowance, the witness utilized a 5.5% annual growth in revenues. The study analyzed the company's past and anticipated growth for different categories of expenses. Findings of the average growth in expense categories are set forth in Exhibit No. 72, Page 8, 9, 10, 11 and 12. The analysis of rate base consisted of analyzing past and anticipating future growth. The analysis is detailed in Exhibit No. 72, page 13.

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Based upon the estimated growth rates for revenue, expenses and rate base, the witness determined the rate of return the company will earn in the year ending November 30, 1982, which is the first year rates resulting from this proceeding will be in effect, calculated as follows. NOI will increase from \$30,833,000 to \$33,459,000. The rate base will increase from \$268,077,000 to \$356,000,997, resulting in a decrease in the rate of return from 11.52% (the rate of return recommended by the staff) to 9.37%, or a rate of attrition of 215 basis points over the 23-month period. The witness recommended, therefore, that an allowance of 2.15% is required to compensate the company for the attrition it will experience for the year ending November 30, 1982 and equals \$14,807,000 in gross operating revenue requirement. The witness then adjusted the latter figure by the revenue compound growth factor of 1.1082 resulting in a recommended attrition allowance of \$13,361,000 in gross operating revenue requirement.

The staff points out on brief that Mr. Louiselle projects that the company will by November 30, 1982, have approximately \$75,349,000 of CWIP in the Colstrip project, an increase of \$59,722,000 over December 31, 1980. This increase in CWIP accounts for \$10,829,000 of the attrition allowance.

We have examined the testimony related to this adjustment with great care. Admittedly, attrition adjustments have been before the Commission in prior rate cases and have been rejected. However, both the circumstances we find in this case and the evidence in support of the adjustment are vastly different than what we have heretofore considered. It is clear on this record that the company's commitment to its construction projects to 1985, and its present program for major projects has created an imbalance in its ability to raise necessary construction funds from internal sources. This in turn has adversely affected the company's financial indices, upon which investors rely in examining the company's financial structure. Upon examination of the detailed analysis of Mr. Louiselle's testimony and supporting exhibits, we are convinced that in order to preserve and maintain the company's financial integrity and allow it to generate sufficient cash flow consistent with its needs for construction projects, and to attract investors at a reasonable cost, the staff's attrition allowance should be accepted. In accepting the attrition allowance proposed herein, we emphasize that such an adjustment for this or any other utility under our jurisdiction will be considered on a case-by-case basis only. We further state that the evidence adduced to support an attrition allowance must be of such a character that will lead us to a firm conviction that not to do otherwise will jeopardize the company's financial integrity and adversely affect the ability of the company to render required service to its customers at reasonable rates.

The Commission's findings on pro forma net operating income are summarized as follows:

SERVICE DATE

DEC 16 1981 61

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION,	)	CAUSE NO. U-81-17
)	
Complainant,	)	SECOND SUPPLEMENTAL
	)	ORDER
vs.)	
)	
PACIFIC POWER & LIGHT COMPANY,)	
)	
Respondent.)	
.....)	

This matter came on regularly for hearing on May 12, June 17 and 18, July 13, 14, and 15, September 30, and October 1, 5, 6, and 27, 1981, pursuant to notice duly given. The hearings were held before Chairman Robert W. Bratton, Commissioner Robert C. Bailey, Commissioner A. J. Benedetti, and Administrative Law Judges Alice L. Haenle, Clarence George, and Pauline C. Nightingale.

The parties were represented as follows:

- COMPLAINANT: WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION
By James R. Cunningham
Assistant Attorney General
Temple of Justice
Olympia, Washington 98504
- RESPONDENT: PACIFIC POWER & LIGHT COMPANY
By Leonard A. Girard
Attorney at Law
900 S.W. 5th
Portland, Oregon 97204
- INTERVENOR: WASHINGTON INDUSTRIAL COMMITTEE
FOR FAIR UTILITY RATES (WICFUR)
By Grant E. Tanner and
David T. Douthwaite
Attorneys at Law
111 S.W. Columbia, Suite 700
Portland, Oregon 97204
- PUBLIC: PEOPLE OF THE STATE OF WASHINGTON
By Joel Smith and
West H. Campbell
Attorneys at Law
P. O. Box 2249
Yakima, Washington 98902

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Twenty-seven members of the public testified at hearings held for that purpose in Walla Walla and Yakima.

ISSUES

The proposed tariff revisions would increase rates and charges for electric service and were designed to add approximately \$16,056,000 to respondent's annual revenues. Staff found a gross revenue deficiency of \$13,621,000. Particular areas of disagreement between respondent and staff are identified below.

The intervenor disagrees with respondent's cost of service study, method of spreading any rate increase among classes of customers, and inclusion of a basic charge in the large general service schedule.

Members of the public variously addressed the hardship of rate increases in general, aspects of rate structure and rate spread, and the cost of respondent's construction program.

I. TEST YEAR

The Commission determines the original cost of a utility's property in service from examination, restatement, and pro forma adjustment of a twelve-month operating period.

Respondent selected calendar year 1981 for its test period, forecasting its Washington operations for that period by following procedures used in establishing operating budgets. This is a departure from the precedent of presenting the most recent available twelve-month period; it is advocated by respondent as a means to mitigate the effects of attrition, or the decline in return experienced during periods when costs rise more rapidly than revenues. Respondent predicates its request for attrition relief on inflation, growth and the higher cost of a new plant to meet new and existing demands, diminished economies of scale in the electric industry, and costs outside the direct control of management such as taxes, fuel prices, and new capital.

Staff used calendar year 1980 as the test period for purposes of this proceeding, rejecting the future test period approach as susceptible to errors in projection which would distort relationships between revenues, expenses, and rate base. In order to address the potential effects of regulatory lag, Mr. Louiselle recommended that an attrition allowance be included in the company's revenue requirement. His recommended attrition allowance was calculated from analysis of past trends in growth of revenues exclusive of rate increases, the various categories of expenses, and the various components of rate base. Based on the growth rates and the dates to which items of revenue, expense, or rate base were proformed in staff's adjustments, compound adjustment factors were derived and applied to adjusted 1980 amounts to project attrition for the year ending November 30, 1982.

The Commission recognizes the effects of attrition on a utility's ability to earn the rate of return authorized for a prospective period if revenues grow at a lesser rate than operating expenses and/or rate base. Staff's attrition adjustment applied to historic rate base as adjusted for known and measurable

changes appears to provide a reasonable approach to the problem while avoiding the potential for distortion and other infirmities inherent in the estimated future test period approach.

The Commission adopts calendar year 1980 as the appropriate test period for purposes of this proceeding and will consider an appropriate attrition allowance in a later section of this order dealing with results of operations.

II. RATE BASE

Table I depicts itemized rate base as presented by the company as adjusted for projected year 1981 and by staff for calendar year 1980. Amounts shown are the average of beginning and end of year amounts; average of monthly average amounts were not available.

TABLE I

PACIFIC POWER & LIGHT COMPANY
 Rate Base - Adjusted
 (\$000 omitted)

	<u>Company</u>	<u>Staff</u>	<u>Difference Staff (less)</u>
Utility Plant in Service	\$335,246	\$335,246	\$ --
Accumulated Provision for Depreciation and Amortization	(63,456)	(63,456)	--
Plant Held for Future Use	731	731	--
Utility Plant Acquisition Adjustment	7	7	--
Nuclear Fuel	122	122	--
Customer Advances for Construction	(112)	(112)	--
Weatherization - Interest Free Loans	2,155	2,155	--
Material and Supplies	5,684	--	(5,684)
Cash Working Capital	2,311	--	(2,311)
Unamortized Leasehold Improvements and other Miscellaneous Items	1,647	--	(1,647)
Extraordinary Property Losses	112	--	(112)
Investor Supplied Working Capital	--	1,808	1,808
Rate Base - Actual	284,447	276,501	(7,946)
Four Uncontested Adjustments	4,090	4,090	--
Contested Adjustments			
RA-5 Weatherization Adjustment	(233)	(479)	(246)
P-3 Jim Bridger Plant	1,327	1,066	(261)
P-4 Dave Johnson Plant	492	395	(97)
P-5 Centralia Plant	150	596	446
AFUDC/CWIP Earnings Adjustment	50,661	3,650	(47,011)
Year End Adjustments	13,173	--	(13,173)
Attrition Adjustments	20,545	--	(20,545)
Rate Base - Adjusted	<u>\$374,652</u> ¹	<u>\$285,819</u> ²	<u>\$(88,833)</u>

¹ Projected Year 1981
² Calendar Year 1980

The uncontested adjustments are restating or pro forma adjustments to property held for future use, Trojan Plant, special sales, purchased power and transmission, and book depreciation update. The uncontested adjustments are accepted.

RATE BASE ACTUAL - WORKING CAPITAL

Respondent's calculation of actual rate base includes materials and supplies, cash working capital according to a 1980 lead-lag study, unamortized leasehold improvements and other miscellaneous items, and extraordinary property losses. Staff excluded these items from rate base and in lieu thereof calculated the amount of investor-supplied working capital associated with utility operations according to balance sheet information, using the beginning and end of year average for purposes of consistency with other rate base component averages used herein. When the balance sheet approach is used, materials, supplies, and deferred debits supplied by investors are reflected in the working capital.

The balance sheet method compares total invested capital with total investment. The percentage of excess investor-supplied capital over investment is applied to Washington rate base to identify the investor-supplied working capital associated with Washington utility operating rate base. Since staff included only a portion of CWIP in rate base as described in Rate Base Adjustment C, infra, a separate working capital allowance was computed by the same method to identify the working capital associated with such CWIP.

We accept staff's working capital analysis as providing a reliable measurement of the amount of working capital upon which investors are entitled to earn a return.

The Commission recognizes that the average of monthly averages for a test period gives a more refined portrayal of average investor-supplied capital. Since such amounts were not available for other rate base components in this proceeding, we find that staff's analysis of working capital best relates to the portrayal of rate base in this cause.

RATE BASE ADJUSTMENTS

A. Weatherization - Interest Free Loans. Both respondent and staff adjusted investment in the weatherization program to remove items which in other states are amortized over a ten-year period but in Washington are expensed on a current basis pursuant to the Commission's order in Cause No. U-78-47. However, respondent added to test period rate base an average amount to reflect the investment balance as of March 31, 1981. Staff rejected this adjustment in favor of the actual average amounts for the test year. The Commission accepts the staff test year average amount.

B. Jim Bridger Plant, Dave Johnson Plant, Centralia Plant. Staff's adjustments reflect the removal of materials and supplies from rate base consistent with its treatment of these items as embedded in the working capital component of rate base. Since we have accepted staff's working capital analysis, these adjustments are also accepted.

C. CWIP Adjustment. The company included all major CWIP in rate base and an AFUDC offset in income at an accrual

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rate of .78 percent less than the fair rate of return. Staff's recommendation is inclusion of CWIP at Colstrip Units 3 and 4 only, with no AFUDC offset, and that AFUDC be accrued and capitalized on all other construction projects at the fair rate of return.

Respondent's major construction projects include Wyodak, the bulk of which may be financed off books via a leveraged lease, WPPSS, Skagit, Pebble Springs, and Colstrip 3 and 4. Completion of WPPSS, Skagit, and Pebble Springs is uncertain. Colstrip 3 and 4 are scheduled to go into service in 1984 and 1985.

Respondent's approach follows practice under recent Pacific Power & Light Company's rate orders issued by the Commission. Mr. Louiselle recommends departure from that practice for considerations involving the company's future financial integrity and the principle that costs should be recovered over the life of the investment.

Using several conservative assumptions, including the assumption that all projects will be completed, and disregarding the impact on revenue of the Economic Recovery Tax Act (ERTA) of 1981, Mr. Louiselle conducted a study of the financial implications of respondent's construction program, analyzing CWIP/AFUDC alternatives for the period 1981 through 1985. For each alternative he determined the AFUDC effect on construction funds obtained internally, the ratio of AFUDC to equity earnings, and various earnings, cash, and indenture coverages. Comparison of the two CWIP/AFUDC treatments presented in this proceeding demonstrates that Mr. Louiselle's proposal produces better financial indicators in each of the years 1982 and 1983, and the company's produces better indicators in 1984 and 1985.

The amount staff includes in test period rate base to reflect Colstrip 3 and 4 CWIP is \$3,626,000. This increase in operating investment would increase the working capital allowance calculated according to staff's method by \$24,000. Thus the amount staff includes in rate base would be \$3,650,000.

In recent rate proceedings involving other electric utilities in Washington (U-80-10, U-80-13, and U-81-15), the Commission has recognized that critical needs for cash earnings may be associated with large construction programs and that application of the AFUDC offset does not provide the cash flow necessary to meet construction requirements on reasonable terms, as well as coverage tests.

Based on the record in this matter, the Commission is of the opinion that Mr. Louiselle's recommendation affords the best balancing of consumer and investor interests for the period the rates governed by this order are likely to be in effect. The Commission therefore accepts staff's CWIP adjustment to rate base.

Both respondent and staff would capitalize AFUDC at the gross rate, or fair rate of return, on CWIP not included in rate base. Respondent compounds AFUDC on a semi-annual basis. The Commission concurs with staff that in the future, Pacific Power & Light Company should compound AFUDC no more often than annually in order to avoid overstating the amount of AFUDC capitalized.

D. Year-End Adjustment. In its presentation of revenues, expenses, and rate base for calendar year 1980, respondent included a year-end adjustment intended to reflect cost increases over test year averages. Nothing in the record suggests that the year-end adjustment achieves a proper matching of revenues, expenses, and rate base. The adjustment is rejected.

E. Minimum Attrition Adjustment. After making its year-end adjustments, respondent added a minimum attrition adjustment to items of revenue, expense, and rate base to bring those items to the levels presented in the company's forecast of calendar year 1981. The adjustment is rejected as susceptible to the same errors and lack of verification as the forecasted test period.

Table II summarizes the Commission's findings on test period rate base:

TABLE II
 PACIFIC POWER & LIGHT COMPANY
 Rate Base - Adjusted
 (\$000 Omitted)

Utility Plant in Service	\$335,246
Accumulated Provision for Depreciation and Amortization	(63,456)
Plant Held for Future Use	731
Utility Plant Acquisition Adjustment	7
Nuclear Fuel	122
Customer Advances for Construction	(112)
Weatherization - Interest Free Loans	2,155
Investor Supplied Working Capital	<u>1,808</u>
Rate Base - Actual	\$276,501
Four Uncontested/Adjustments	4,090
Contested Adjustments	
RA-5 Weatherization Adjustment	(479)
P-3 Jim Bridger Plant	1,066
P-4 Dave Johnson Plant	395
P-5 Centralia Plant	596
AFUDC/CWIP Earnings Adjustment	<u>3,650</u>
Rate Base - Adjusted	<u>\$285,819</u>

III. RATE OF RETURN

Table III shows capital structure and rate of return as presented by respondent and by staff:

SERVICE DATE

MAR 12 1982

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND)	
TRANSPORTATION COMMISSION,)	
)	
Complainant,	)	CAUSE NO. U-81-41
)	
vs.)	
)	
PUGET SOUND POWER & LIGHT	)	SECOND
COMPANY,	)	SUPPLEMENTAL ORDER
)	
Respondent.)	
.....)	

This case concerns tariff revisions filed by Puget Sound Power & Light Company ("Puget", "Respondent" or "Company") with the Washington Utilities and Transportation Commission ("Commission") on May 14, 1981. The company says that these tariff revisions, if allowed to become effective, would increase Puget's rates and charges for electric service by \$131,508,574 a year based on accounting analysis of the company and its performance during 1980.

By complaint and order, the Commission on May 20, 1981, suspended the proposed tariff revisions and started this proceeding to determine whether the revisions would result in rates that were fair, just and reasonable.

Pursuant to notices given in accordance with the requirements of law, hearings about the filing were held at Olympia on July 10, September 9, 10, 11 and 14, October 14, 15, 16, 19 and 20, and December 14, 15 and 16, 1981. Special hearings, just to receive evidence from members of the public, were also held at Olympia on December 16, at Bellingham on December 17 and at Bellevue on December 18. The hearings were before Commission Chairman Robert W. Bratton, Commissioner Robert C. Bailey and Commissioner A. J. Benedetti. The principal Administrative Law Judge for the proceeding was C. Robert Wallis; Administrative Law Judges William Metcalf and Pauline C. Nightingale presided at some of the hearing sessions.

The parties were represented as follows:

COMPLAINANT: WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION
By James R. Cunningham
and Douglas N. Owens
Assistant Attorneys General
Temple of Justice
Olympia, Washington 98504

RESPONDENT: PUGET SOUND POWER & LIGHT COMPANY
By William S. Weaver
and Douglas S. Little
Attorneys at Law
1900 Washington Building
Seattle, Washington 98101

A. Capital Structure

The staff, through Mr. Lurito, recommends a capital structure containing 46.2% debt, including 3.5% short-term debt; 15.3% preferred stock and 38.5% common equity. This capital structure is derived from the company's actual capital structure at December 31, 1980, adjusted for the projected 1981 and 1982 financing of the company. As with the staff's other recommendations regarding Puget, this capital structure treats the Colstrip 3 and 4 subsidiary financing as off-books as to Puget; this capital structure is thus not a "consolidated" capital structure. The company accepted the proposed capital structure for purposes of this proceeding, based upon the staff recommendations on other issues, some of which we here decline to accept.

Considering all factors, we accept this pro forma capital structure which Mr. Lurito proposes as a reasonable capital structure, balancing safety and economy for the benefit of stockholder and ratepayer alike.

B. Cost of Debt

(1) Financial Attrition

One of the elements which we are asked to consider in judging the fair rate of return for Puget is what has been called "financial attrition", or the expectation, based on recent history, that embedded financial costs will rise during the period that the rates are in effect, resulting from enlargement of the funding pool and replacement of earlier, lower-cost debt issues. It is suggested by staff and the company, and we agree that it is appropriate, to use pro forma cost rates recognizing the reasonably-expected financings and the reasonably-expected cost rates for those financings, to account for financial attrition.

(2) Cost of Debt

We accept Mr. Lurito's recommendation to pro forma to December 31, 1982, and we update his cost figure to 10.02% embedded cost of debt at the December 31 date, based upon the recent experience of record in Puget's latest debt issue and our expectation that the near-term future circumstances will be consistent with the recent experience.

C. Preferred Stock

In order to fully recognize the continually rising embedded costs, we will accept a pro forma figure based upon reasonably-expected costs as of December 31, 1982.

Mr. Lurito on behalf of staff recommends an embedded cost rate as of 12/31/82 of 11.62%, and the company recommends embedded cost of 12.20%.

Again, based upon recent history and near-term expectations, we anticipate that the company's recommended 12.20% cost rate for preferred stock will more accurately represent the company's costs as of year-end 1982, and we accept the 12.20% figure proposed by the company.

D. P-16 Rate Case Expense

The staff by this adjustment reduces the company's estimate of rate-case regulatory fee expense because the Commission costs experienced in this proceeding will not exceed the level requiring further contributions by the company. On brief, the company accepts this adjustment.

E. P-23 Tax Benefit of Pro Forma Interests

This adjustment is proposed by staff to reflect the tax effects of the Commission's use of a pro forma level of debt expense in the analysis of the company's rate base. The company agrees on brief with the theory of the adjustment and the sole question here is as to the proper figure to relate to our determinations in the rate base section of this order. We have calculated the proper figure to be \$6,089,422 and, consistent with the policy recommendations of the parties, will use that figure in our analysis of the company's results of operations.

F. Attrition Adjustment

During periods of relative economic stability, a test year analysis produces valid information not in a measurement of the level of various expenses during the test period, but in the relationships between revenues and expenses. A properly adjusted test period under those conditions will in the time following the analysis show a relatively constant relationship which will permit company operations to proceed on a relatively stable basis with relatively satisfactory funding.

In recent years, rapid inflation has caused company expenses to rise disproportionately to revenues. Under these circumstances, rates which are set at a given level with reference to an adjusted test period are insufficient to keep pace with the expenses driven upward by inflationary pressures.

This Commission, as have other Commissions, has searched for mechanisms to deal with the problem of meeting inflationary pressures. In other cases we have considered various mechanisms, including end-of-period test year analysis and "attrition adjustments" which purport to raise various financial elements beyond the end of the test period to account for experienced or expected inflationary pressures.

In this proceeding, we recognize financial attrition and authorize the respondent to consider in rates the effects of issues of debt and preferred stock which will not occur until months following the issuance of our order. In addition, the discounted cash flow analysis of equity also recognizes the inflationary expectations of investors to the extent that those expectations of inflation require compensation.

Both the company and the staff recommend attrition allowances in this proceeding by which various of the company costs are inflated to levels which the proponent of the adjustment foresees as likely in the medium-term future.

The staff, through witness Louiselle, presents an attrition adjustment of about \$7.6 million at the net operating income

level. The company agrees with the staff, but suggests additional adjustments which, including a power supply attrition adjustment, bring the total requested company attrition adjustment up to nearly \$15 million. We have above treated the power cost attrition issue and will not further speak to it.

For several reasons, as to this company in its present circumstances, we reject the requested adjustments.

First, the company's recent actual results of operations demonstrate that it is keeping pace with recent levels of inflation and is in fact improving its operating results. Recent economic measures undertaken by the federal government have led to a substantial slackening of inflation to the point where near-term future inflation levels may not be accurately predicted by recent term past inflationary levels and the attrition estimates of the witnesses may be significantly higher than the actual levels to be experienced.

Unrebutted testimony by numerous members of the public gives us substantial reason to believe that serious efforts at improving efficiencies and at achieving economies in day-to-day operations would produce substantial results for the respondent. While we do not accept as truth the public fear that the company considers ratepayers to be a money machine removing all need for cost consciousness, we do believe that an attrition adjustment would tend to dampen management incentive to achieve efficiencies in staff and in use of other resources.

Under the circumstances of this case, we believe that it is proper to deny the requested attrition adjustments in light of recent positive company performance, recent trends toward the abatement of inflation and the effect of such an adjustment to reduce substantially management incentive to achieve efficiencies in operation.

G. Allowance for Funds Used During Construction

The allowance for funds used during construction is an accounting procedure by which credit is made to the revenue account in order to balance entries made to the capital account of construction work in progress. This is an accounting adjustment only and does not reflect real revenues received by the company. The company accepts the staff adjustment, but it is based upon the staff recommendation that all CWIP should be included in rate base subject to a 9% AFUDC offset. Ultimately the adjustment sum would be capitalized and become a part of the CWIP capital total when the various projects become used and useful in utility operations and thus a part of the rate base.

We have above rejected the underlying staff recommendation, however, and in our treatment we have accepted only a limited sum of CWIP for rate base inclusion -- major projects WPPSS 3 and Colstrip 3 and 4 transmission facilities -- and we are accepting those without AFUDC offset. Therefore, we reject the recommended AFUDC offset adjustment.

SERVICE DATE
MAY 16 1986 364.

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND)	
TRANSPORTATION COMMISSION,)	
)	
Complainant,	)	CAUSE NO. U-85-53
)	
vs.	)	SECOND SUPPLEMENTAL ORDER
)	
PUGET SOUND POWER)	
& LIGHT COMPANY,)	
)	
Respondent.)	
.....)	

PROCEEDING

On August 14, 1985, Puget Sound Power & Light Company, hereinafter referred to as "respondent", "company", or "Puget", filed tariff revisions (UTF 85-248) designed to produce a general increase in its rates and charges for electric service in the State of Washington in the amount of \$78,816,448. Tariff filings were suspended by Commission Order issued August 28, 1985. On rebuttal, the company reduced its request to \$68,228,731.

HEARINGS: Hearings were held before Chairman Sharon L. Nelson, Commissioner Robert W. Bratton, Commissioner Richard D. Casad, and Administrative Law Judge Rosemary Foster of the Office of Administrative Hearings, pursuant to due and proper notice to all interested parties. Hearings were held in Olympia, Washington, on October 4, November 4 and 5, and December 19 and 20, 1985 and February 18-20, and March 24 and 25, 1986. Hearings to receive public testimony were held in Olympia, Washington, on February 21, 1986, Auburn, Washington, on March 6, 1986, and Bellevue, Washington, on March 7, 1986.

APPEARANCES: The respondent was represented by the law firm of Perkins, Coie, Stone, Olson, and Williams, by William S. Weaver, Priscilla W. Derick, and Douglas S. Little, attorneys at law, Seattle; the staff of the Washington Utilities and Transportation Commission was represented by James R. Cunningham and Marjorie R. Schaer, assistant attorneys general, Olympia. The Office of Public Counsel was represented by Charles F. Adams, Robert F. Manifold, and David Robbins, assistant attorneys general, Seattle. The following intervenors appeared: Direct Service Industrial Customers of the Bonneville Power Administration (DSI) and Washington Industrial Committee for Fair Utility Rates (WICFUR) were represented by David H. Lohman and Grant E. Tanner, attorneys at law, Portland; Bonneville

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VIII. ATTRITION

Attrition is a complex phenomenon which results from an unbalanced growth in revenues, expenses and/or rate base that causes a change in the rate of return from its authorized level. Commission staff witness Bruce M. Louiselle proposes that a negative attrition adjustment be adopted by the Commission for this proceeding. Beginning with actual test year results of operation, Mr. Louiselle estimates growth in revenues, expenses and rate base to reach a projection of the expected change in the rate of return during the time when rates from this case are in effect. According to Mr. Louiselle, complete analysis of attrition is especially important in this case as Puget has incorporated in its base case the two most significant causes of attrition, plant and expense growth, while failing to consider potential significant offsetting factors such as revenue growth. The witness analyzes changes in the company's first year rates caused by depreciation expense, property taxes, income taxes, revenue growth and net electric plant. Combined with these factors are revenue requirements and sales growth.

Mr. Louiselle challenges the company's assumption that its investment in the Washington Public Power Supply System nuclear plant No. 3 at Satsop, Washington should be included in the attrition year calculations. He argues that this assumption would be tantamount to Commission acceptance of the company's proposal to amortize WNP No. 3 investment in rates beginning January 1, 1987. Based upon the results of four analyses featuring varying treatment of tax and conservation variables, Mr. Louiselle concludes that a negative attrition adjustment should be reflected in Puget's revenue requirements.

On rebuttal, Mr. Story agreed to Mr. Louiselle's treatment of property taxes. However, three issues remain which differentiate the Commission staff's approach from the company method:

1. Calculation of income taxes for the attrition year;
2. Inclusion of WNP No. 3 in the attrition year rate base for the period from January 1, 1987 through March 31, 1987.
3. Use of different growth revenue forecasts for the attrition year.

Company witness Mr. Moreton offered an adjustment to the Commission staff income tax calculation by adding back the difference between attrition year and test year depreciation. Company witness Mr. Hoff offered an adjustment to lower the Commission staff growth factor from 7.3% to 6.93%. Company witness Charles Olson contends

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that the failure by Commission staff to include WNP No. 3 in the attrition year understates attrition by \$7.3 million.

In its brief, Commission staff pointed out that while the company projected revenue growth of 7.3%, its power cost estimates were predicated on an 8.11% growth in sales, which, upon further analysis, translates into a 7.5% growth in sales and a 7.3% growth in revenues which are virtually identical to those relied upon by Mr. Louiselle. Commission staff also challenges the company's calculation of tax deduction for depreciation. Finally, Commission staff urges that the ratemaking treatment for WNP-3 be considered in a separate proceeding and that no aspect of it be included in the attrition year.

Public Counsel opposes attrition adjustments in general but contends that in this case, the company has considered future changes in costs without giving comparable weight to changes in revenues. Public counsel particularly objects to the inclusion of WNP-3 costs in a portion of the attrition year.

The Commission accepts the Commission staff's proposed negative attrition adjustment. Review of the revenue growth projections indicates that Mr. Louiselle's figures more closely represent growth to be anticipated during the period when rates from this proceeding are in effect. The Commission finds that his computation of attrition year income taxes is appropriate and does not suffer from the error which the company contends. Finally, we do not agree that WNP-3 costs should be included in this proceeding under any guise. We anticipate that the WNP-3 costs and their appropriate disposition will be the subject of a separate proceeding. It is improper to suggest that they be included as a part of this attrition adjustment.

IX. REVENUE REQUIREMENTS

The Commission has found that the appropriate rate of return for the respondent's actual electric operation is 10.93% for the test year. Based on the following table, the Commission finds the respondent's gross revenue deficiency is \$28,840,720. Table IX displays the computation of the gross revenue deficiency based upon a conversion factor of 0.5049378.