Agenda Date: October 24, 2019

Item Numbers: A1 and A2

Dockets: UE-190274 and UG-190275
Company: Puget Sound Energy

Staff: Aimee Higby, Regulatory Analyst

Recommendation

Issue an order in Dockets UE-190274 and UG-190275, (1) approving, in part, the petition filed by Puget Sound Energy, Inc., on April 10, 2019, authorizing deferred accounting treatment for depreciation expense associated with the Get to Zero initiative, but only for projects that meet the materiality threshold articulated by commission staff in its memo; (2) denying Puget Sound Energy's request to include a carrying charge on the deferral balance at the company's rate of return; and (3) denying Puget Sound Energy's request for deferred accounting treatment for future projects placed in service after the current general rate case.

Overview of Filing

On April 10, 2019, Puget Sound Energy (PSE or company) filed with the Washington Utilities and Transportation Commission (commission) a petition for deferred accounting treatment associated with the company's Get to Zero (GTZ) initiative.[1] PSE's request pertains to projects with a book life of 10 years or less and placed in service after June 30, 2018.[2]

PSE requests deferred accounting treatment for depreciation expense incurred during the 13-month period of May 1, 2019, through May 31, 2020.[3] PSE also requests to assess a carrying charge on the deferral balance at the company's rate of return and that they be allowed to defer depreciation expense for any future qualifying GTZ investment that is placed into service beyond the current GRC.

Core Issue

Deferred accounting typically is used for extraordinary events, such as when a utility incurs a substantial change in costs associated with an unforeseeable event, like a major winter storm or tax reform. This accounting petition asks that the commission treat certain utility investments as extraordinary events.

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[1] PSE is a combined electric and gas utility serving over 1.1 million electric customers and approximately 830,000 natural gas customers.
[2] June 30, 2018, marks the end of the test year used for PSE's Expedited Rate Filing. Including only those projects placed in service after that date ensures the projects subject to this accounting petition are not already reflected in current rates.
[3] June 1, 2020, is the PSE's requested effective date for its current general rate case, Dockets UE-190529 and UG-190530.

This petition raises major policy questions, and the commission's response may have long-term consequences with respect to how and when petitions for deferred accounting are used. This petition essentially asks the commission to answer the following questions:

1. Do projects under the GTZ umbrella create extraordinary circumstances that merit deferred accounting treatment for the depreciation expense?
2. If the commission authorizes deferred accounting treatment for depreciation expense for projects under the GTZ umbrella, which projects are appropriate to include in the deferral and which are not? What are the qualifying criteria?

Although staff recommends the commission authorize deferred accounting here, it does so only for short-lived assets that meet the materiality threshold staff describes in this memo. However, staff makes this recommendation as a temporary stop-gap until the commission provides policy guidance on whether and when deferred accounting treatment is appropriate for utility investments in short-lived plant.

Background

Get to Zero

GTZ is not a single project, per se. Rather, GTZ represents a number of projects between 2016 and 2021 that are part of PSE's "digital transformation initiative." The initiative includes projects focused on digital channels which customers use to access information related to billing, outages and service requests. GTZ projects are spread across four functional categories: (1) customer interface, (2) billing payment credit & collections, (3) integrated work management, and (4) data management and analytics. Examples of projects within the GTZ initiative include investments for a new web platform, new mobile application, automation investments related to integrated work management for different business units, integrated voice response improvements, and projects related to customer billing and payments.

Context: Limitations of Standard Ratemaking Framework

The commission's standard ratemaking framework uses a modified historical test year with limited pro forma adjustments. The historical test year creates a snapshot of operations over a recent year, matching revenues, expenses and rate base over a defined period of time. Due to the "historical" nature of the test year, there is a lag between when a cost is incurred and when it is reflected in rates. Limited pro forma adjustments for plant are meant to reduce some of this lag by capturing in rates major investments made by the utility after the test year has ended.

Although this process has generally worked well when a utility invests in large, long-lived plant, it is not as accommodating to assets that don't qualify as "major," but due to their short book lives and high depreciation rates, could nevertheless have a material financial impact on a company. Regulatory lag is not inherently a negative thing; however the shorter an asset's life, the more meaningful regulatory lag becomes, making it more likely utilities will request extraordinary regulatory treatment for those assets.

Deferred Accounting Treatment

Deferred accounting treatment typically is used when a utility experiences an extraordinary cost that could not have been accounted for in the rates in effect at that time. Ordinarily, an expense, no matter how extraordinary, is recognized in the period in which it occurred, and matched to the revenues in that same period. In limited circumstances, the commission allows an extraordinary expense to be deferred as a regulatory asset and recognized in a future period so that new revenues can be matched to that expense. When it authorizes deferred accounting treatment the commission implicitly is (1) accepting that the circumstances giving rise to the expenses are extraordinary; and (2) acknowledging that absent a deferral, authorized rates are insufficient. These are not trivial matters.

Deferral of Depreciation Expense: a Word of Caution

PSE's petition requests deferred accounting treatment for depreciation expense for a number of projects that it lumps together under an initiative umbrella. With its petition, PSE is asking that the commission accept that this collection of projects, and the depreciation expenses associated with each of these projects, represent extraordinary circumstances that warrant special accounting treatment.

Staff recommends the commission exercise an abundance of caution when it comes to deferring depreciation expense as it essentially amounts to accepting that utility *investments* now represent extraordinary events that, absent deferred accounting treatment, render currently authorized rates insufficient. Unless circumstances truly are extraordinary, the commission should make determinations with respect to revenue insufficiency through a general rate case.

Discussion

The GTZ Initiative is an Umbrella Term for Multiple Projects

When evaluating whether to authorize deferred accounting treatment, the commission should note that GTZ is not one single investment; it is an "initiative," used as an umbrella term to capture multiple discrete projects. Some GTZ projects were placed in service during the ERF test year (July 2017 through June 2018), some projects were placed in service during the test year for the current GRC (which captures the remainder of 2018), some projects were placed in service during the pro forma period in the current GRC (through June 2019), and additional projects will be placed in service at various points over the next two years.

The commission should not think of GTZ as "a project." Accordingly, the commission should consider this petition as a request for deferred accounting treatment for several projects placed in service on 14 separate dates between July 1, 2018, and June 30, 2019, and for the depreciation expense for these projects accumulated between May 1, 2019, and May 31, 2020. Staff recommends the commission determine whether each project on its own qualifies for special accounting treatment.

Recommendation – Deferred Accounting Treatment for GTZ

In general, staff is supportive of efforts to adapt the existing regulatory framework to evolving business circumstances, including increased pressure to invest in modernization and information technology. Staff also accepts the premise that regulatory lag can become problematic for utilities investing in these kinds of assets, which tend to be short-lived, and in limited circumstances deferred accounting treatment may be appropriate. However, it is difficult to say whether deferred accounting treatment is warranted for GTZ. Even if the commission determines that the circumstances with respect to GTZ are extraordinary, it has yet to be determined whether rates currently in effect are insufficient to cover these expenses. Therefore, it is uncertain whether deferred GTZ costs are appropriate for recovery.

Given that the commission has yet to provide guidance on this matter, staff recommends that the commission authorize deferred accounting treatment here, but it should limit this special treatment to significant projects. Below, staff presents a new approach for assessing materiality that accommodates smaller, short-lived assets. To the extent that the commission is convinced that investments in short-lived plant create extraordinary circumstances, this materiality threshold should be applied when considering whether an individual investment contributes materially to those extraordinary circumstances.

Materiality Threshold

When determining whether to authorize special accounting treatment for an investment, the commission should consider whether that investment rises to the occasion. For example, PSE requests that the commission authorize deferred accounting treatment for an $823,000 project in the GTZ basket with a book life of 10 years and an annual depreciation expense of $82,000. Without question, this is not a material expense worthy of extraordinary regulatory treatment.

To determine what is “material,” staff proposes an approach that considers the gross cost impact of the project. Under the traditional materiality test, which sets the threshold at 0.5 percent of net plant in service, a “major” investment for PSE would be an investment over $45 million on a total company basis. Converting that threshold into a gross cost number that includes both depreciation expense and return on rate base, a material project is one with a gross cost impact of approximately $4 million. A gross cost threshold allows the commission to assess not just whether a capital investment is big enough to be “major,” but also whether the depreciation expense contributes materially to financial results. In this way, staff’s proposed threshold allows for fair consideration of the materiality of smaller investments with short book lives.

PSE requests deferred accounting treatment for various projects placed in service across 14 dates. When staff’s proposed criteria are applied, only projects placed in service on three of those 14 dates qualify as material. However, the qualifying projects placed in service on those three dates represent nearly 60 percent of the amount PSE requests to defer. Whereas PSE requests $29.0 million, staff recommends $16.7 million.

Request for a Carrying Charge

PSE requests the deferral balance accrue a monthly carrying charge equal to the company's current rate of return. Staff recommends the commission deny this request. Authorization of the accounting petition itself represents an extraordinary regulatory action, providing the company with special treatment for $16 million of depreciation expense, even though those expenses occurred during a period in which the commission has already determined rates to be sufficient. A request for a carrying charge is an argument that ratepayers *owe* PSE this deferral, and PSE *deserves* to collect interest on the money ratepayers owe. Ratepayers did not underpay, and they do not deserve to be charged interest simply because the commission was generous in providing PSE with extraordinary accounting treatment.

Request for Deferral for Future Investments

PSE asks that the commission's authorization be open-ended so that all future qualifying GTZ investments receive deferred accounting treatment. Staff strongly recommends the commission deny this request. Ignoring for the moment it is not evident that every project with a GTZ label warrants special regulatory treatment, PSE is requesting deferred accounting treatment for hypothetical expenses, for projects that have not been identified, and during a period for which rates have not yet been set. It is not possible to assess whether extraordinary circumstances will exist at that time such that as-of-yet authorized rates will be rendered insufficient. Moreover, PSE essentially asks that the commission accept that the revenues it authorizes through the pending GRC will be insufficient the moment they are authorized. The commission should not accept this.

The Need for Policy Guidance

As utility business models refocus on distribution services and information technology, and until the commission's standard ratemaking framework has been reformed or adapted to changed circumstances, one-off proposals for extraordinary regulatory treatment, especially for short-lived assets, will likely grow. Staff encourages the commission to consider offering policy guidance on this matter, either through a standalone policy docket or as part of the commission's existing inquiry into the adequacy of the current regulatory framework. While deferred accounting could have some value in this context, it should only be used in extraordinary circumstances. The commission should consider offering guidance on what constitutes extraordinary circumstances and when the use of deferred accounting is warranted.

Conclusion

Staff recommends the commission grant PSE's petition, in part, for projects placed in service between July 1, 2018, and June 30, 2019, but only for projects that meet staff's proposed materiality threshold. Staff recommends this approach as a one-time stop-gap until the commission provides policy guidance on this matter. Staff also recommends that the commission deny PSE's request for a carrying charge on the deferral balance, and deny PSE's request for deferred accounting treatment for unknown investments to be placed in service after the current general rate case.