ATTORNEY GENERAL OF WASHINGTON

Public Counsel
800 Fifth Ave • Suite 2000 • MS TB-14 • Seattle WA 98104-3188 • (206) 464-7744

August 5, 2019

SENT VIA WEB PORTAL
Mark L. Johnson
Executive Director and Secretary
Washington Utilities and Transportation Commission
1300 S. Evergreen Park Dr. SW
P. O. Box 47250
Olympia, Washington 98504-7250

Re: *Inquiry into Valuation of Public Service Company Property Used and Useful after Rate Effective Date*, Docket U-190531
Public Counsel First Comments

Dear Mr. Johnson:

Public Counsel submits the following comments pursuant to the Utilities and Transportation Commission's ("Commission") Notice of Opportunity to File Written Comments dated July 5, 2019 ("Notice"). The Washington State Legislature passed ESS SB 5116, which, in part, amends RCW 80.04.250, and requires the Commission establish an appropriate process to identify, review, and approve public service company property that becomes used and useful for service in the state after the rate effective date. The process developed by the Commission through this inquiry must uphold key regulatory principles while providing robust and fair oversight over investor-owned utilities. These comments will first address the questions posed in the Commission's Notice, and then will offer general comments and observations.

Question 1: In order for property to be considered for inclusion in rates during the rate effective period, should such property specifically be identified in the general rate case giving rise to those rates, or can specific property be identified in a subsequent proceeding? If such property may be identified in a subsequent proceeding, what proceeding would that be and why?

To the extent that rates are set using rate base in the calculation, utility property should be identified in the general rate case setting those rates. Generally, the regulatory principle of used

and useful "requires that costs associated with [plant] be paid by the ratepayers who benefit from the plant." *Kentucky Util. Co. v, FERC*, 760 F.2d 1321, 1324 n.4, 245 U.S. App. D.C. 297 (D.C. Cir. 1985). Plant "must be in commercial operation and providing net benefits to customers in order for expenses associated with it to be included in rate base." *Town of Hingham v. Dept. of Telecomm. and Energy*, 433 Mass. 198, 202, 740 N.E.2d 984 (S.C. Mass. 2000). However, after *Hope* and *Bluefield*, "used and useful ceased to have any constitutional significance," absent statutory mandate. *Jersey Cent. Power & Light Co. v. FERC*, 810 F.2d 1168, 1175, 98 P.U.R.4th 536, 258 U.S. App. D.C. 189 (D.C. Cir., 1987).

Washington has a statutory mandate for used and useful. Recent legislation, the Clean Energy Transformation Act (CETA), modified the used and useful statute, but did not abolish the used and useful standard in Washington. CETA modified RCW 80.04.250 to state:

> The Commission has power upon complaint or upon its own motion to ascertain and determine the fair value for rate making purposes of the property of any public service company used and useful for service in this state by or during the rate effective period …
>
> The Commission may provide changes to rates under this section for up forty-eight months after the rate effective date using any standard, formula, method, or theory of valuation reasonably calculated to arrive at fair, just, reasonable, and sufficient rates. The Commission must establish an appropriate process to identify, review, and approve public service company property that becomes used and useful for service in this state after the rate effective date.
>
> ….
>
> Nothing in this section limits the Commission's authority to consider and implement performance and incentive-based regulation, multiyear rate plans, and other flexible regulatory mechanisms.

Engrossed Second Substitute S.B. 5116, 66th Leg., 2019 Reg. Sess. (WA 2019).

CETA does not allow rates to be set without adhering to regulatory principles such as used and useful, the matching principle, known and measurable, or prudence, which protect customers from paying a return of and on utility property that never materializes. Indeed, CETA expressly contemplates that the UTC will identify, review, and approve utility property used to provide service in the event that the UTC approves rate changes for up to 48 months after the general rate case's rate effective date. This oversight of property that becomes used and useful after the rate effective date is particularly important to protecting customers.

It appears that CETA contemplates the following three types of utility property: (1) property that is in service but not yet in rates, (2) property that goes into service after the test period but before

the rate effective date, and (3) property that is anticipated to be in service during the rate effective period.

In cases decided before CETA, property that is in service but not yet in rates will be captured in a rate case, assuming the property meets regulatory standards and is prudent. Property that goes into service after the test period but before the rate effective date is subject to *pro forma* plant adjustments in rate cases; such property may be added to rate base through a *pro forma* adjustment if the property is used and useful, the cost is known and measurable, and the plant is prudent. Property that is anticipated to be in service during the rate effective period has historically failed the known and measurable standard because the Commission could have no way of knowing whether the property would be completed and placed into service or at what cost. *See WUTC v. PacifiCorp d/b/a Pacific Power & Light*, Docket UE-130043, Order 05, ¶ 205 (Dec. 4, 2013)(citing *WUTC v. Puget Sound Energy*, Dockets UE-090704 and UG-090705, Order 11, ¶ 26 (Apr. 2, 2010). The utility could seek cost recovery of this future property in a future rate case.

Going forward, with all three types of property contemplated by CETA, the utility should specifically identify the property during the rate case in which the property is included in rates. How the first two types of property are treated does not fundamentally change under CETA. Treatment of the third type of property is now subject to an exception to the used and useful standard if the Commission approves a multiyear rate plan.

Allowing plant into rates before it goes into service resembles pre-approval, which the Commission has long resisted. *WUTC v. Avista Corp.*, Dockets UE-160228 and UG-160229, Order 06, ¶ 72 (Dec. 15, 2016). Moreover, prudence can only be determined after a capital project is complete. The Commission has noted, "Prudence determinations are made after the fact, usually after the capital project is complete at which time the Commission can evaluate whether it is used and useful and provides benefits to ratepayers commensurate with its final costs." *Id.* If plant is allowed in rates before it is placed in service, as contemplated by CETA, utilities must justify their plant requests with sufficient specificity and detail allowing the Commission and parties to determine need, certainty of completion, and benefits to customers. This showing, however does not establish prudence; prudence cannot be determined in the underlying general rate case. As CETA requires, subsequent proceedings are necessary to ensure that the plant did go into service and that the utility's investment is prudent.[1]

Allowing plant not identified into rates, and waiting to identify plant in a subsequent proceeding, is inadequate. Waiting for future identification of property included in customer rates essentially provides the utility with a blank check for rate base.

[1] As discussed in Public Counsel's response to Question 3, this subsequent proceeding will ensure that anticipated plant went into service. If the plant did not go into service, or cost materially less than the amount included in rates, rate base would be adjusted to reflect this.

Question 2: How should plant-in-service be valued (for the determination of rate base) for each year of a rate plan? Does this valuation depend on prospectively identifying specific plant investments across the rate plan during the general rate case giving rise to the rates? Why or why not?

Rate base for the first year of a rate plan should consist of plant in service (and any appropriate pro forma plant adjustments). UTC should continue its practice of using net book value for valuation, and this should apply to all plant that are included rate base. Valuation requires identification of plant investments across the rate plan and should require that rate base be trued-up to ensure that anticipated, future plant materializes and is prudent. The subsequent true-up ensures that rates are just, reasonable, and sufficient, and also fair.

Under CETA, multiyear rate plans may require estimation of rate base during future years in the rate plan. Plant estimations should correlate to plant that actually serves customers during the rate plan. The utility should demonstrate in their initial filing that the rates they seek in a multiyear rate plan adequately correlate to plant that is needed and will provide customer benefits. Ultimately, all plant included in rates must meet the Commission's prudence standard, and prudence of future plant must be determined in subsequent proceedings.[2] Policies set by the Commission in this docket should be carefully crafted to avoid providing an incentive to utilities to build to earlier projections. *See WUTC v. Avista Corp.,* Dockets UE-160228 and UG-160229, Order 06, ¶ 68 (Dec. 15, 2016).

Additionally, use of statistical analysis cannot be the end of the inquiry with respect to valuing rate base in future years of a rate plan. The Commission stated:

> Statistical analyses do not identify or establish causal relationships. Indeed, for example, it is clear that a regression analysis performed on historical data projected into future years, no matter how statistically significant the results may be, simply will tell us nothing that would help determine whether some unspecified future investment will meet the used and useful test. Similarly, such a statistical analysis can tell us nothing about prudence, which is not a general, abstract inquiry, but rather one tied to individual projects the Company decides to, and does, undertake.

WUTC v. Avista Corp., Dockets UE-160228 and UG-160229, Order 06, ¶ 71 (Dec. 15, 2016).

While CETA allows statistical analysis *vis a vis* the used and useful test, as applied to multiyear rate plans, the Commission is not excused from conducting a prudence review, which necessarily must be done after the plant is identified, placed into service, and used to provide ratepayer benefits.

---

[2] *See* Public Counsel's response to Question 1 above.

Question 3: What should be the review process for property included in rates that becomes used and useful after the rate effective date? Is this review process the same for plant placed in service both up to and during the rate-effective date?

This question assumes that property has been included in rates, but that the property becomes used and useful after the underlying rate case has concluded and after new rates have gone into effect. The review process for all plant should be equally rigorous, regardless of whether the process takes place in a general rate case or some subsequent proceeding. Fundamentally, the Commission must adequately review all plant included in rate base used to set customer rates. This adequate review requires that all plant included in rate base meet fundamental regulatory standards. Those standards include whether the plant is used and useful, whether the cost of the plant is known and measurable, and whether the utility's investment in the plant is prudent. In Public Counsel's view, the review process should be the same for plant placed in service both up to and during the rate effective period.

The Commission will review plant that goes into service before the rate effective date in the underlying general rate case.[3] CETA requires that the Commission conduct a subsequent proceeding to identify, review, and approve property going into service after the rate effective period. In this subsequent proceeding, the Commission will evaluate plant included in rate base that is placed into service during the rate effective period to determine whether it should remain in rate base. This process will confirm that the plant was completed, at what cost, and that the utility placed the plant in service. This process will further evaluate prudency of the plant. Depending on the length of the rate plan, the frequency of the subsequent rate base proceedings might vary. It might be appropriate to hold such proceedings annually.

As a result of being required to submit to a subsequent rate base proceeding, utilities are not entitled to a blank check with respect to their rate base. Rather, utilities must demonstrate prudence. Stakeholders, such as Public Counsel, the Alliance of Western Energy Consumers, Commission Staff, and others, must be afforded the opportunity to address prudence in a subsequent proceeding where the property has been completed and can be adequately evaluated. Further, if the utility is not able to demonstrate that the property meets the regulatory standards, the Commission should remove the property from rate base. This ensures that ratepayers do not pay for rate base that does not materialize.

Question 4: Should *pro forma* plant additions placed in service after the test year but before the rate effective date be considered using the same process that the Commission will use to identify, review, and approve property that becomes used and useful after the rate effective date? Or, should these post-test year plant additions be considered under a separate process? What is the best way to incorporate the participation of all the parties to the underlying rate proceeding in the process of reviewing the prudence of these post-test year plant additions?

[3] *See* Public Counsel's response to Question 4 below regarding treatment of *pro forma* plant additions.

Pro forma plant additions are plant additions made after the test period, but before the rate effective period. The Commission has allowed *pro forma* plant additions, although parties often argue over when a specific plant addition is too late to be included in a *pro forma* plant adjustment. The controversy is rooted in parties' ability to review the plant addition. The Commission has resisted applying a bright line rule establishing when plant may be considered for inclusion in a *pro forma* adjustment. *WUTC v. PacifiCorp d/b/a Pacific Power & Light Co.*, Docket UE-130043, Order 05, ¶¶ 189 – 200 (Dec. 4, 2013).

Pro forma plant should be considered in the general rate case in which they are included in rate base. Property placed into service after the rate effective date should not be characterized as "*pro forma*," but rather they constitute a new category of utility property that statutorily may be included in rates. The Commission will conduct a proceeding to identify, review, and approve capital additions made during the rate effective period.[4] If there are plant additions that fall into a gray area – plant that is placed into service before the rate effective date, but too late to be evaluated and included in a *pro forma* plant adjustment – the Commission could order that plant be subject to the post-rate-case plant proceeding if it also orders a multiyear rate plan. Otherwise, the utility could seek cost recovery of all plant not included in rate base in a future rate case.

The best way to incorporate participation of all the parties to the underlying rate case is to establish a presumption that plant placed into service after one month prior to response testimony is too remote for inclusion in a *pro forma* plant adjustment. A presumption would allow the Commission to continue to exercise discretion upon good cause that the presumption should not apply to specific plant additions.

The best way to incorporate participation of all the parties to the underlying rate case in any subsequent process is to provide specific notice to those parties of the subsequent process. Additionally, adequate time to review, prepare analysis, and present analysis is important for party participation. The Commission should use the adjudication process to evaluate property that becomes used and useful during the rate effective period.

Question 5: If the rate base used to establish rates for a multi-year rate plan relies on a formula or plant-in-service projections (rather than a prospective identification of specific investments), what is the appropriate process for identifying, reviewing, and approving property that becomes used and useful for service after the initial rate-effective date? How should actual plant-in-service relate to the plant-in-service used to establish rates?

Rates set using a formula that escalate the amount in rate base with no bearing on actual plant, while expressly allowed in statute, is a method that should be used sparingly as customers bear the risk of paying for amounts associated with plant that does not exist and may never exist.

In its initial filing, a utility should demonstrate that the level of rate base requested is commensurate with the level of rate base needed to serve its customers. If that rate base is higher

[4] *See* Public Counsel's response to Question 3 above.

than the rate base currently in rates, the utility should demonstrate why the increase is necessary. Rate base included in customer rates should be based on an evaluation of need for that rate base.

As required by CETA, the Commission should establish a robust process to identify, review, and approve property that is placed into service after rates have been set, and this is especially important if the Commission allows rates to be set using a formula. That process should require the utility to present information to satisfy the used and useful standard, the known and measurable standard, and the Commission's prudence standard. The parties to the underlying rate case should be notified and should be afforded the opportunity to participate, including seeking discovery and presenting evidence. The Commission should hold a hearing to consider the evidence and decide whether the plant in service is prudent and should remain in rate base. If the plant that went into service during the rate effective period is less than the rate base allowed in rates, customers may be entitled to a rate reduction.[5]

Ultimately, rate base should be trued up to reflect actual plant in service to ensure that customers are paying for actual plant, particularly since customer rates provide both return on and return of capital costs associated with plant.

General observations:

As the Commission designs the process under which it will identify, review, and approve utility property that becomes used and useful during the rate effective period, Public Counsel urges the Commission to incorporate customer protections into the process. The Commission plays an essential role of providing robust and fair regulatory oversight of monopoly providers of essential services. Such oversight ensures that utilities charge fair and reasonable rates and provide safe and reliable services.

As a general matter, utilities are not entitled to recover every expense they incur, including costs associated with rate base. The Commission is empowered to review a utility's expenses and disallow those expenses that are not prudently incurred. Only prudently incurred expenses are recoverable, and the Commission must balance both customer and shareholder interests in setting rates.

The used and useful standard requires that utility property be employed for service to customers in Washington and be capable of being put to use for service. The utility must demonstrate quantifiable benefits to ratepayers for property to be included in rates. *WUTC v. PacifiCorp d/b/a Pacific Power & Light Co.*, Docket UE-140762, Order 08, ¶ 166 (Mar. 25, 2015). The used and useful standard was modified under CETA to expressly recognize the considerable discretion held by the Commission. Even so, the standard continues to exist in Washington and remains an important regulatory principle.

For all property included in rate base, customers should pay only for property that is used and

[5] *See* Public Counsel's response to Question 3 above.

useful, known and measurable, and prudent. With the processes allowed for under CETA, customers may be asked to pay for property in rates that is not yet known and measurable or established to be prudent. It is important that the Commission develop processes to fully evaluate all plant included in rate base and used to set customer rates. Any review that takes place in a subsequent proceeding must be equivalent to the review the Commission would conduct in a general rate case. This review should be robust and sufficient to allow parties to provide evidence to the Commission on which the Commission can make a determination. The Commission should adjust rate base if property is not completed, does not cost as much as anticipated, or is deemed to be imprudent, and should adjust customer rates accordingly.

Public Counsel looks forward to engaging in this docket as the Commission develops the process required by CETA to identify, review, and approve utility property that becomes used and useful in the rate effective period. We appreciate the opportunity to submit these comments and look forward to reviewing comments filed by other stakeholders. To the extent the Commission develops rules and conducts workshops in this docket, Public Counsel will actively participate. Any questions about these comments may be directed to Lisa Gafken at Lisa.Gafken@ATG.WA.GOV or (206) 464-6595.

Sincerely,

LISA W. GAFKEN
Assistant Attorney General
Public Counsel Unit Chief
(206) 464-6595

LWG/CM