

**BEFORE THE WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION**

In the Matter of)	DOCKET U-150040
)	
Investigation of possible ratemaking)	COMMENTS OF THE INDUSTRIAL
mechanisms to address utility earnings)	CUSTOMERS OF NORTHWEST
attrition)	UTILITIES
_____)	

I. INTRODUCTION

1 On February 5, 2015, The Washington Utilities and Transportation Commission (the “Commission” or “WUTC”) issued a Notice of Opportunity to File Written Comments (“Notice”) regarding an investigation of possible ratemaking mechanisms to address utility earnings attrition. The Industrial Customers of Northwest Utilities (“ICNU”) appreciates the opportunity to participate in the upcoming workshop scheduled by the Commission, and submits these Comments in response to Commission requests stated in the Notice.

II. COMMENTS

2 As a general matter, ICNU supports the efforts of the Commission and Commission Staff to formalize discussion concerning attrition, given the rise in utility claims of earnings attrition in recent years. The Commission approved attrition adjustments for a period in the early 1980s, in response to exceptionally high inflation and interest rates.^{1/} Neither of which are present today. Then, for nearly two decades, attrition adjustment requests were almost

^{1/} WUTC v. Puget Sound Energy, Inc. (“PSE”), Dockets UE-111048 and UG-111049 (consolidated), Order 08 at ¶ 489 (May 7, 2012).

unheard of in Washington, after the Commission rejected a proposed attrition adjustment for Washington Natural Gas in 1993 stating: “An adjustment for attrition is an extraordinary measure, not generally included in general rate relief. A request for such an adjustment should be based on extraordinary circumstances”^{2/}

3 In recent years, however, despite historically low interest rates and inflation levels, Washington utilities have begun asking for rate increases based wholly or in part on attrition factors. Notwithstanding the Commission’s decisions in the 1993 Washington Natural Gas proceeding, these attrition adjustments have not been premised on the existence of “extraordinary circumstances.” Rather, they have been proposed as a permanent exception to the Commission’s traditional ratemaking methodology that relies on the use of a “modified” historical test year.^{3/} As discussed in detail in these Comments, ICNU does not believe that this newfound reliance on attrition theory is warranted or should result in any departure from the Commission’s long-standing policy, which limits the use of an attrition adjustment as an “extraordinary measure” justified only by “extraordinary circumstances.”

4 While ICNU may have further comments on attrition, and reserves the right to respond to other parties’ comments, these Comments are meant to address specific Notice requests, including the provision of information and analysis that ICNU believes will help inform the Commission on this issue.

^{2/} WUTC v. Wash. Natural Gas, Docket UG-920840, Fourth Suppl. Order at 29-30 (Sept. 27, 1993).

^{3/} WUTC v. Pacific Power & Light Co., Dockets UE-140762 *et al.*, Order 08 at ¶ 20 (Mar. 25, 2015). See also Dockets UE-111048 and UG-111049 (consolidated), Order 08 at ¶¶ 93-94 (quoting from a WUTC order that “describes the long-standing practice in Washington that relies on a so-called modified historic test year approach”).

A. Earnings Attrition Causation

5 The Commission has requested organizational perspectives “on the causes(s) of utility earnings attrition,” and has provided potential examples such as “high inflation, aggressive capital investment...low/no load growth.”^{4/} Generally, ICNU has not identified any evidence to demonstrate that earnings attrition is a problem in the current economic environment nor has it identified any factors in the current regulatory framework that would preclude electric utilities from the opportunity to earn a fair return. Each of the electric utilities in Washington has been earning a return that is well within a range of reasonableness, and each will continue to have an opportunity to earn a reasonable return based on the current use of a modified historical test period.

6 Moreover, ICNU takes the perspective that any claims of earnings attrition in the current economic environment are best ascribed to the ordinary business risk associated with utility operations. The Commission has recognized that a degree of regulatory lag is a factor that will encourage utilities to operate efficiently.^{5/} Yet, the attrition methodologies recently advanced by utilities would largely eliminate any such incentive, as well as the ordinary business risk associated with utility operations. The Process of Ratemaking, cited previously by the Commission concerning attrition,^{6/} acknowledged this—suggesting that the discussion of attrition sometimes “approaches an effort to underwrite company performance.”^{7/} ICNU strongly opposes regulatory efforts to underwrite utility performance, irrespective of actual

^{4/} Notice at 2.

^{5/} WUTC v. PacifiCorp, Docket UE-130043, Order 05 at ¶ 181 (Dec. 4, 2013).

^{6/} Dockets UE-111048 and UG-111049 (consolidated), Order 08 at ¶ 490, n. 671.

^{7/} Leonard Saul Goodman, *The Process of Ratemaking* at 637 (Public Utility Reports, Inc. 1998).

economic performance through the use of attrition adjustments. A utility must be subject to ordinary business risks, which will encourage it to operate efficiently in the public interest. As the U.S. Supreme Court has noted, “regulation does not assure that the regulated business make a profit.”^{8/}

7 Rather, ICNU supports the Commission’s principle that “[r]egulation is a surrogate for competition.”^{9/} Indeed, one of the guiding principles stated by the Commission for electric utility regulation in Washington is that “regulation cannot and should not be expected to guarantee that utilities will, in all circumstances, be made entirely whole for generation or other costs that are determined through actual and fair competition to be stranded or *uneconomic*.”^{10/} Accordingly, just as non-regulated companies in the competitive market are forced to manage their cost structures to achieve profit targets, so too should a regulated utility pursue every opportunity to manage costs of service in order to realize profit targets at a pricing structure that is just and reasonable.

8 Utilities do, in fact, have the opportunity to mitigate alleged earnings attrition through cost management and capital prioritization. To illustrate, the present docket was initiated as a result of Avista Corporation’s (“Avista”) 2014 general rate case.^{11/} While the Commission approved a settlement stipulation in that case without considering the merits of

^{8/} Mkt. St. Ry. Co. v. R.R. Comm’n of State of Cal., 324 U.S. 548, 566 (1945) (citing Fed. Power Comm’n v. Hope Natural Gas Co., 320 U.S. 591, 603 (1944)).

^{9/} Re the Review of: Unbundled Loop and Switching Rates; the Deaveraged Zone Rate Structure; and Unbundled Network Elements, Transport, and Termination (Recurring Costs), Docket UT-023003, Twenty-fourth Suppl. Order at ¶ 83 (Feb. 9, 2005).

^{10/} Re the Commission’s Notice of Inquiry: Examining Regulation of Electric Utilities in the Face of Change in the Electric Industry, Docket UE-940932, Policy Statement at 2 (Dec. 13, 1995) (emphasis added).

^{11/} Notice at 1.

Avista’s claims of earnings attrition,^{12/} ICNU submitted testimony indicating that Avista had previously achieved an equity return that *exceeded* authorized levels, and had done so through cost control measures and increased rates.^{13/} Avista had removed over \$5 million in costs through its Voluntary Severance Incentive Plan alone.^{14/} Such measure and control over internal utility costs indicates that utilities can and do eliminate alleged “earnings attrition” all on their own, simply by operating in an efficient and economic manner.

9 Ultimately, the creation of a new attrition methodology as a permanent exception to the use of a modified historical test period would run counter to the Commission’s expectation that each utility should earn its authorized rate of return “by instituting effective cost-cutting measures.”^{15/} While an attrition adjustment may be appropriate in truly “extraordinary circumstances,”^{16/} as when a “utility can demonstrate *extreme* financial distress,”^{17/} the use of an attrition adjustment should not be permitted as a matter of course.

10 ICNU recommends that, in considering the “cause(s)” of attrition, the Commission is best served in focusing on the extraordinary circumstances that may lead to extreme financial distress or some other gross inequity. Applying this rubric to the three potential causes of attrition in the Notice—“high inflation, aggressive capital investment, low/no load growth”—it should be apparent that, in the current economic environment, none of these factors should be expected to lead to extreme financial distress or gross inequity to a public

^{12/} WUTC v. Avista, Dockets UE-140188 and UG-140189 (consolidated), Order 05 at ¶¶ 48-49 (Nov. 25, 2014).

^{13/} Dockets UE-140188 and UG-140189 (consolidated), Mullins, Exh. No. BGM-1CT at 14:12-13.

^{14/} Id. at 14:9-13.

^{15/} WUTC v. PSE, Dockets UE-130137 *et al.*, Order 07 at ¶ 163 (June 25, 2013).

^{16/} Docket UG-920840, Fourth Suppl. Order at 30.

^{17/} WUTC v. Avista, Dockets UE-120436 *et al.*, Order 09/14 at ¶ 77 (Dec. 26, 2012) (emphasis added).

utility. Low inflation rates experienced recently are not extraordinary relative to the high inflation experienced in the early 1980s. The capital investments of utilities are being promptly evaluated in rates within the context of the modified historical test period when determined to be known and measurable. Finally, lower than expected load growth is an ordinary risk associated with operating a utility business, which does not place upon utilities any gross inequity that would warrant the use of an attrition adjustment.

11 Thus, the cause of any earnings attrition present in the current economic environment is the result of the ordinary business risk of operating a public utility. As with any unregulated entity competing in the market, a utility should be responsible for managing its capital investment or adjusting to demand changes economically. If a utility cannot or will not do so, then the Commission is not obligated to “assure that the regulated business make a profit.”^{18/}

B. Preferred Attrition Mechanism

12 If and when extraordinary circumstances occur, such that a utility can demonstrate extreme financial distress and gross inequity, despite diligent cost management, ICNU prefers the use of discrete pro forma adjustments as a mechanism to account for earnings attrition. More specifically, ICNU supports the use of the Commission’s current modified historical test period, which relies on “[p]ro-forma adjustment of test-year data to reflect known and measurable changes in conditions or costs incurred subsequent to the end of the test-year.”^{19/}

^{18/} Mkt. St. Ry., 324 U.S. at 566.

^{19/} Dockets UE-111048 and UG-111049 (consolidated), Order 08 at ¶ 491.

1. Benefits and Shortcomings of Various Approaches

13 Under the Commission's traditional modified historical test period approach, pro forma adjustments include only those cost items that are "known and measurable." The principle benefit to ratepayers from this approach is the exclusion of speculative and unjustified costs in rates. On the utility side, it is not unreasonable to require that the utility collect no more than what is verifiable and measurable in rates. ICNU is not supportive of any departure from a known and measurable ratemaking standard and has concerns over the efficacy of approving the prudence and ratemaking of attrition-related costs which are neither known and measurable, nor subject to full review in a regulatory proceeding.

14 Of the alternatives mentioned in the Notice, ICNU believes that an "attrition allowance" is susceptible to the greatest shortcomings and least benefits. As the Commission has explained, "an 'attrition allowance' usually is based," in significant part, on "trended historical analysis."^{20/} ICNU has sponsored testimony on both the conceptual and technical shortcomings inherent in trending analyses recently submitted to the Commission within an "attrition study."^{21/} For example, the unreliability of historical trending analyses is perfectly demonstrated by an illustration of natural gas price forecasting; using price data from 2007-2012, linear trending analysis would have produced a 2014 forecast price *below zero*.^{22/}

15 An attrition allowance methodology is also flawed because only those utilities with rapidly increasing costs and capital expenditures would benefit from a trend-based attrition

^{20/} Dockets UE-111048 and UG-111049 (consolidated), Order 08 at ¶ 491, n. 673.

^{21/} E.g., Dockets UE-140188 and UG-140189 (consolidated), Mullins, Exh. No. BGM-1CT at 14:16-16:4; Dockets UE-120436 *et al.*, Gorman, Exh. No. MPG-1T at 4:1-14:18.

^{22/} Dockets UE-140188 and UG-140189 (consolidated), Mullins, Exh. No. BGM-1CT at 15:4-12.

allowance. A utility that is working hard to reduce its costs and prioritize capital expenditures could, in fact, be penalized and subject to a negative attrition adjustment under such a methodology. In its 2014 general rate case, Pacific Power cited such reasoning in its opposition to the use of an attrition allowance methodology.^{23/} One of its reasons in that case for not proposing an attrition allowance adjustment similar to that proposed by Avista was that the “existing mechanisms assume a consistent level of growth in the costs that PacifiCorp is actively managing to control.”^{24/} ICNU agrees with this characterization. Rewarding those utilities with rapidly escalating costs, while penalizing those which are undertaking efforts to control costs, would not be in the public interest, and should not be given consideration by the Commission.

16 Moreover, if a trending analysis became a permanent ratemaking methodology, customers would never see the full benefit of utility savings efforts. This was discussed in Avista’s 2014 general rate case by ICNU witness Mr. Mullins, who noted “if a trending analysis is approved on an ongoing basis the rates paid by customers will never fully reflect those savings initiatives, as the Company’s revenue requirement will continually be escalated above the level in the test period when the savings were achieved.”^{25/}

17 Finally, an attrition allowance methodology presents a number of additional regulatory and legal hurdles with regard to capital expenditures. First, applying a trending methodology to rate base provides an incentive for utilities to “gold-plate” their system, and discourages them from prioritizing expenditures. A utility has complete control over the level of

^{23/} Dockets UE-140762 *et al.*, Dalley, Exh. No. RBD-1T at 11:8-17.

^{24/} Id.

^{25/} Dockets UE-140188 and UG-140189 (consolidated), Mullins, Exh. No. BGM-1 CT at 16:1-4.

capital that it deploys. As a result, it would have the ability, as well as the incentive, to increase the amount of capital expended in order to influence the trending rates used in an attrition allowance methodology. This results in a self-fulfilling cycle, in which the utility must continue to spend exponentially in rate base in order to sustain the increasing trends in capital expenditures, a result which is not in the public interest.

18 Second, under an attrition allowance methodology, the Commission would allow the Company to earn a return on capital expenditures that have not been determined to be prudent and in the public interest. The Commission, under its rate fixing authority, has an obligation to evaluate whether rates are, among other things, just, reasonable, and non-discriminatory.^{26/} In order to make such an evaluation, the information under evaluation by the Commission must be discrete, known and measurable capital items. Attrition adjustments, however, are not discrete, known and measurable cost items. Rather, attrition adjustments represent an abstract layer of “padding” added to the utility’s rates to reflect some future, unknown expenditure to the utility. Because it is not known what the attrition capital expenditure will be, however, the Commission has no basis to demonstrate that those unknown expenditures are just, reasonable, and nondiscriminatory.

19 ICNU believes that the use of a future test year would also implicate the same shortcomings and issues as an attrition allowance, because any future test year would have to be based on projections of costs that are not known and measurable such as budgets, which are highly discretionary. The use of a future test year exacerbates the problems associated with the

^{26/} RCW § 80.28.020.

use of end-of-period rate base balances, in which utility revenues and rate base no longer satisfy the fundamental matching principle aligning costs and benefits. Likewise, the inclusion of construction work in progress in rate base, which the Commission has described as “providing a return on investment *prior* to when the new plant goes into service,”^{27/} violates both the matching principle and the Commission’s used and useful standards.

2. The Relationship of Causation and Solution

20 The Commission has asked for discussion as to whether different causes of attrition require different ratemaking solutions. In ICNU’s view, the relationship between causation and solution is not relevant for two primary reasons. First, since any attrition adjustment should only be based on truly “extraordinary circumstances,”^{28/} only one causation factor is relevant—the “extraordinary” nature of circumstances. Second, further granularity in the causation analysis is not necessary or even helpful, given that one solution is sufficient to address any instance of extraordinary circumstances that would justify an attrition adjustment. That is, because the current regulatory framework based on a modified historical test period already adequately ensures that utilities will have access to capital, ICNU supports the use of the Commission’s current regulatory framework as the continued mechanism to mitigate earnings attrition, in keeping with the Commission’s long-held known and measurable standard.

^{27/} Dockets UE-111048 and UG-111049 (consolidated), Order 08 at ¶ 491 (emphasis added).

^{28/} Docket UG-920840, Fourth Suppl. Order at 29-30.

C. Attrition in the Context of a Historical Test Year

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The Commission requests that organizations “discuss why it would or would not be appropriate to consider potential earnings attrition” within a historical test period context.^{29/} ICNU understands that Washington uses a *modified* historical test period, not a historical test period.^{30/} The modified historical test period includes normalization and pro forma adjustments, which are designed to mitigate earnings attrition. The use of the currently approved pro forma adjustments, as a mechanism to address earnings attrition, is the best means to adhere to traditional ratemaking principles—while still providing utilities with a degree of protection against attrition not available from a purely historical test period. All other alternative mechanisms are incompatible with the fundamentals of a modified historical test year and would require the Commission to institute broad changes to its entire ratemaking approach.

D. Requirements and Parameters of Preferred Pro Forma Mechanism

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The Commission should continue to apply standards it has previously articulated concerning pro forma adjustments within the context of a modified historical test period. Other essential ratemaking standards, such as the known and measurable, used and useful, and matching principles must be retained. In the following subsections, ICNU answers specific questions posed in the Notice.

^{29/} Notice at 2.

^{30/} Dockets UE-140762 *et al.*, Order 08 at ¶ 20. See also Dockets UE-111048 and UG-111049 (consolidated), Order 08 at ¶¶ 93-94 (quoting from a WUTC order that “describes the long-standing practice in Washington that relies on a so-called modified historic test year approach”).

1. Should an Attrition Analysis Include Historical Data Only?

23 Yes. If there is to be an attrition adjustment, the use of pro forma adjustments already provides flexibility to utilities that goes beyond the parameters of a historical test year. Yet, by requiring fidelity to the known and measurable standard through the use of actual historical data, pro forma methodology does not depart from the long-standing ratemaking principles established in Washington.

2. Should Rate-Year Capital Budgets Be Considered?

24 No. This would require a paradigm shift from the Commission, disregarding its current implementation of the known and measurable standard. Rate-year capital budgets would require the Commission to approve rate base associated with capital projects *prior* to a determination of whether the project was prudent. Pacific Power, in its 2014 general rate case, included in its initial filing capital expenditures which were based on budgeted amounts. These budgeted amounts, as well as expenditure timing, changed several times and materially throughout the proceeding.^{31/} Because capital budgets are constantly changing, having the potential to change materially between a rate case and the rate year, it would not be appropriate for the Commission to approve the prudence of a capital project, based on a budgeted amount, until the final capital expenditures associated with the project are known with certainty.

25 In addition, if the Commission allows rates to be set based on budgeted projections, all a utility needs to do in order to verify its budget is to ensure that it spends all the forecasted amounts—whether it really needs to or not. In fact, ICNU has sponsored testimony

^{31/} E.g., Dockets UE-140762 *et al.*, Mullins, Exh. No. BGM-1CTr at 11:10-15, 12:9-13:9; Ramas, Exh. No. DMR-1CTr at 14:12-15:6; Erdahl, Exh. No. BAE-1T at 8:5-7.

raising concerns that Avista may be doing exactly this, by coupling an attrition study with a “cross-check” study.^{32/} Such a dynamic creates an incentive for the utility to always spend up to or over its budgeted amounts, else the validity of its forecasts will soon be called into question. Likewise, a utility in this position would have a disincentive to achieve efficiencies and cost savings, because the cycle of continued forecasting validity and compounding rate increases completely depends on continued increases in spending.

3. Should There Be a “Bright-Line” Cutoff Date for Including Pro Forma Plant in Rate Base?

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No. In keeping with the Commission’s recent rejection of “bright-line” cutoff dates for pro forma additions, ICNU does not support an arbitrary cutoff date.^{33/} More specifically, the Commission determined that “bright-line” standards in this regard were “too rigid,” and opted for a more “flexible” approach.^{34/} In keeping with the known and measurable standard applicable to pro forma adjustments—as affirmed by the Commission in the very same order—pro forma costs must still be known and measurable in order to be included in rate base.^{35/} Hence, there will always be an inherent cutoff point beyond which pro forma additions will be ineligible for inclusion in rate base, just as the Commission rejected the inclusion of PacifiCorp’s Merwin Fish Collector in its 2013 general rate case because its costs were based only on projections and estimates falling short of the known and measurable standard.^{36/}

^{32/} Dockets UE-140188 and UG-140189 (consolidated), Mullins, Exh. No. BGM-1CT at 9:6-11.

^{33/} Docket UE-130043, Order 05 at ¶¶ 198-200.

^{34/} Id. at ¶ 199.

^{35/} Id. at ¶¶ 203-206.

^{36/} Id. at ¶¶ 205-206.

4. What Level of Precision Should Be Expected for Projected Capital Budgets (Budgeted to Actual) for Ratemaking?

27 ICNU does not believe that projected capital budgets are appropriate for ratemaking, for reasons stated above. Notwithstanding, in those rare instances when projections, budgets, or forecasts may be permissible as an exception to the known and measurable standard, the Commission should continue to “demand a high degree of analytical rigor” on the part of a utility sponsoring a projection,^{37/} before even considering an adjustment based on such information.

28 The Commission noted in Avista’s 2012 general rate case “that the [attrition] testimony and trending data offered in support of the proposed rate increase for 2014 are *substantially* less precise than we would require in a fully-litigated rate case.”^{38/} ICNU maintains that the Commission should continue to insist upon high standards of rigorous analysis, in the event that any projections are considered in regard to attrition adjustments.

III. CONCLUSION

29 ICNU appreciates the opportunity to submit comments regarding the investigation into possible attrition mechanisms, and looks forward to further participation in workshops or comment periods regarding this proceeding.

^{37/} Id. at ¶ 205 (quoting WUTC v. PSE, Dockets UE-090704 *et al.*, Order 11 at ¶ 26 (Apr. 2, 2010)).
^{38/} Dockets UE-120436 *et al.*, Order 09/14 at ¶ 72 (emphasis added).

Dated this 27th day of March, 2015.

Respectfully submitted,

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