BEFORE THE WASHINGTON
UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of Inquiry into Valuation of Public Service Company Property Used and Useful after Rate Effective Date	**DOCKET U-190531**

COMMISSION STAFF COMMENTS REGARDING APPLICATION OF THE "USED AND USEFUL" STANDARD, RCW 80.04.250, AS AMENDED BY E2SSB 5116, LAWS OF 2019, Chapter 288, Section 20

AUGUST 5, 2016

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I. BACKGROUND

In the 2019 regular session, the Washington State Legislature passed Engrossed Second Substitute Senate Bill 5116 (SB 5116) which, among other things, amended RCW 80.04.250, the provision empowering the Commission to value utility property for ratemaking purposes. The pertinent sections of RCW 80.04.250 now read, in relevant part (with new language underlined):

> *RCW 80.04.250(2) 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 and shall exercise such power whenever it deems such valuation or determination necessary or proper under any of the provisions of this title.*[1]
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> *RCW 80.04.250(3) 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.*[2]

On July 5, 2019, the Commission issued a Notice of Opportunity to File Written Comments (Notice), soliciting the perspective of interested persons on the appropriate process for identifying, reviewing, and approving public service company property that becomes used and useful for service in Washington State after the rate effective date of tariffs associated with a general rate case (i.e. rate effective date). These comments of Commission Staff respond to that Notice.

II. STAFF COMMENTS

A. Preliminary Remarks

Staff appreciates the opportunity to provide feedback to the Commission as it contemplates the process for reviewing investments that become used and useful after the rate effective date and as it considers what level of policy guidance the Commission should provide with respect to the modified used-and-useful standard more generally.

Although the Commission's solicitation for comments appears specific to RCW 80.04.250(3) (i.e. the "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"), the amendment to RCW 80.04.250(2) modifies the legal standard known as the "used-and-useful"

[1] RCW 80.04.250(2) goes on to read "The valuation may include consideration of any property of the public service company acquired or constructed by or during the rate effective period, including the reasonable costs of construction work in progress, to the extent that the commission finds that such an inclusion is in the public interest and will yield fair, just, reasonable, and sufficient rates."

[2] RCW 80.04.250(3) also includes language regarding multi-year rate plans, stating "the commission may provide changes to rates under this section for up to 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."

standard and provides the foundation for the utility property subject to the review process identified in RCW 80.04.250(3).

In other words, processes contemplated under RCW 80.04.250(3) are directly related to the scope of ratemaking frameworks the Commission interprets to be allowed under the modified used-and-useful standard, RCW 80.04.250(2). For that reason, Staff believes it is important for the Commission to also discuss the amendment to RCW 80.04.250(2), the revised used-and-useful standard.

B. Fundamental Considerations

1. What is the scope of this inquiry? RCW 80.04.250(3), or RCW 80.04.250 more broadly?

The Notice for Comments solicits feedback on the "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." That is, the Notice suggests the Commission is considering developing policy guidance only with respect to subsection 3 of RCW 80.04.250. However, as noted above, the Commission's regulatory purview is affected by amendments beyond those in subsection 3. More specifically, both RCW 80.04.250(2) and RCW 80.04.250(3) contain amended language with important effects on how the Commission values plant investments for inclusion in rates. The two primary effects are:

1. RCW 80.04.250(2) modifies the used-and useful standard, providing the Commission clear authority to include in rates plant that is not yet in service (but will be in service before or during the rate-effective period); and
2. RCW 80.04.250(3) requires the Commission to establish a process to review plant that is placed in service after rates [which include that plant] become effective.

Importantly, RCW 80.04.250(2) modifies a legal standard while RCW 80.04.250(3) relates to a Commission review process. Staff recommends that the Commission clarify whether it intends to limit its policy guidance to RCW 80.04.250(3) (implying it will decline to advise on the modified used-and-useful standard), or whether it intends to provide policy guidance on RCW 80.04.250 more broadly (implying it intends to provide interpretation or policy guidance with respect to the modified used-and-useful standard).

Also, if the Commission does decide to offer guidance on RCW 80.04.250 more broadly, Staff recommends the Commission create a clear delineation between the guidance it offers for RCW 80.04.250(2) versus the guidance it offers for RCW 80.04.250(3); the Commission should offer different levels of policy guidance for administrative processes versus legal standards embedded in statute.

2. Rulemaking vs. Interpretive and Policy Statement

Staff does not recommend that the Commission initiate a rulemaking at this time, either for implementing the modified used-and-useful standard or for defining a process for reviewing property that becomes used-and-useful after the rate-effective date.

In amending RCW 80.04.250, the legislature made explicit that the provisions of Section 20 of SB 5516 were to ensure that the Commission has sufficient flexible authority to determine the value of utility property for rate making purposes.[3] The Commission should strive to maintain the flexibility afforded by statute, and it can do that by declining to publish rules for the implementation of RCW 80.04.250. Instead, the Commission should publish an Interpretive and Policy Statement that better accommodates flexible approaches to rate making methodologies.

Staff recommends that the Commission set out the process it intends to for identifying, reviewing, and approving property that becomes used and useful during the rate effective period in an interpretive and policy statement. Doing so will allow the Commission to communicate a process it can apply in a flexible manner before ultimately setting it out in rule as favored under Washington's Administrative Procedure Act.

3. The Commission must also provide guidance on the "known and measurable" standard.

The Commission's standards for pro forma adjustments require, among other things, a known and measurable event.[4] For adjustments related to plant, the known and measurable standard has effectively overlapped with the used and useful standard: plant not yet in service is not used and useful and the transfer of the balance to plant-in-service is not known and measurable.

This overlap may no longer hold true under SB 5116. The Commission, by statute, may now value plant that will be placed in service several years after the rate-effective period begins for inclusion in rates. But the Commission's rules would seem to preclude it from including such property in rates under both the known and measurable prongs of WAC 480-07-510(3)(c)(ii).

To ensure that the Commission's rules do not frustrate the legislative purpose animating SB 5116, the Commission should offer guidance on how it intends to apply the known and measurable standard moving forward.

4. Is using a trended rate base an acceptable ratemaking practice?

The Commission should consider offing guidance on whether it intends to continue allowing statistical trending of rate base (e.g., attrition allowance, k-factor), for the calculation of rates during the rate year or for a multi-year rate plan.

This Notice for Comments solicits feedback into the process to identify, review, and approve property that becomes used and useful for service after the rate effective date. However, what the Commission determines to be an appropriate review process may depend on whether

[3] Laws of 2019, ch. 288, § 20(1).
[4] WAC 480-07.510(3)(c)(ii).

the Commission interprets "property," as contemplated by the law, to refer to specific investments.

In contemplating its authority under RCW 80.04.250, the Commission plausibly could interpret "property" to refer to the *level* of plant-in-service used and useful during the rate-effective period, rather than the specific investments identified in advance of completion. If "property" refers to the *level* of plant-in-service used and useful during the rate-effective period, it is conceivable that the statistical escalation of rate base remains a valid ratemaking tool.

However, the Commission should consider that the process to identify, review, and approve the level of property that becomes used and useful for service after the rate effective date will probably look very different than the process to identify, review, and approve the specific investments that become used and useful for service after the rate effective date. The process to identify, review, and approve a statistically trended future level of rate base, for example, might only entail verification that the utility grew its rate base consistent with the trend, and as a practical matter likely precludes a critical examination of every investment included in the total rate base amount. On the other hand, the process to identify, review, and approve specific investments entails a critical look at each investment for which extraordinary rate treatment was granted.

Staff recommends that the Commission move beyond allowing the use of trended rate base, such as that used for calculating an attrition allowance. Aside from the legal uncertainty associated with trended rate base, the move toward Commission review of utility investment plans provides a much more solid basis upon which to calculate rates for future periods.

Staff recommends that in issuing its policy guidance the Commission establish a link between utility investment plans and the investments included in rates but not used and useful for service until after the rate effective date. In Section 1 of SB 5116, the legislature declared that utilities in the state have an important role to play in the transition to clean energy, and must be fully empowered, through regulatory tools and incentives, to achieve the goals of this policy. Thus, the investments included in utility Clean Energy Investment Plans (CEIPs) are excellent candidates for investments included in rates prior to being used and useful. To the extent that Commission review of utility investment plans becomes standard practice, investments beyond those identified in CEIPs could also be included for similar rate treatment.

C. Responses to Commission Questions

1. 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?

Yes, in order for property to be considered for inclusion in rates during the rate effective period, such property should be specifically identified in the general rate case giving rise to those rates, but with the caveat that the Commission provide policy guidance on this matter as interim guidance.

To allow for the consideration of non-traditional forms of regulation, and to maintain flexibility in its approach to cost recovery, the Commission should be clear that the policy guidance it offers here should not be interpreted to preclude the development and implementation of alternative approaches to utility rate making. For example, the Commission could choose to adopt a ratemaking framework that is not tied to utility investment in rate base, and in that event the requirement to specifically identify utility property would be unnecessary and potentially counter-productive.

As an interim application of the modified used-and-useful standard, specific plant should be identified so that the Commission can determine *whether* it is appropriate to include in rates prospectively. As the Commission develops guidance on this issue, it should consider whether to place practical limitations on the investments considered for the extraordinary rate treatment now afforded under the modified used-and-useful standard. Are there certain types of investments for which special ratemaking treatment is warranted?

Staff recommends that the Commission provide basic parameters for the types of projects appropriate for inclusion in rates prior to being used and useful for service. The Commission should consider the following candidates:

a. Investments identified in utility Clean Energy Implementation Plans;

b. Investments identified in other (non-CETA) investment plans, to the extent an "approval" process for such plans exists or is created by the Commission;

c. Investments in IT or other projects with short depreciable lives; and

d. Investments that meet the Commission's definition of "major."

This might be the most practical near-term application of the modified used and useful standard, and it could relieve utilities' need to file serial rate cases while allowing the Commission time to develop more sophisticated, longer-term modifications to its regulatory framework.

If such property may be identified in a subsequent proceeding, what proceeding would that be and why?

Staff is indifferent to whether the review would occur in a proceeding within the original GRC docket or another newly created docket. However, conducting the review in the GRC docket in which the rates were provided for the property in question seems to make the most sense, particularly if rates are subject to refund and the refund is tied to the review. Conducting the review in the GRC docket also would allow parties granted intervenor status to easily participate in the review process.

2. Question 2

How should plant-in-service be valued (for the determination of rate base) for each year of a rate plan?

As an interim application of the modified used-and-useful standard, and in an effort to address ratemaking challenges associated with certain kinds of investments, the Commission should value plant-in-service consistent with how it has always valued plant-in-service, except now by relaxing the limitations on pro forma plant adjustments.

The Commission can use its standard ratemaking approach, whereby property is valued using historical test year plant-in-service, with pro forma adjustments to capture certain projects placed in service after the test year. However, whereas typically projects are not included as pro forma adjustments to plant-in-service if they are not in service by a certain "cutoff" date (within a GRC), under the modified used-and-useful standard that cutoff date can be relaxed. That is, certain qualifying projects can be included as pro forma adjustments even if they are not placed in service until well after the cutoff date (or even in the rate year). Staff recommends that with this approach, the Commission continue to include certain qualifying criteria when considering pro forma plant adjustments.

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?

Yes, particularly if the Commission intends to steer away from statistical escalations of rate base. Further, the law implies that rates must be tied to specific property, and it does not distinguish between rates in year one versus rates in year four: "The valuation may include consideration of any property of the public service company acquired or constructed by or during the rate effective period." To provide a consistent approach to how the Commission values utility property for ratemaking purposes, the Commission should limit the inclusion in rate base to the identification of specific assets.

It is worth noting here that utility investment plans are themselves multi-year plans, and to the extent the Commission considers including in rates certain investments identified in those plans, but prior to them being used and useful, investment plans are relevant across a multi-year rate plan time horizon.

3. Question 3

What should be the review process for property included in rates that becomes used and useful after the rate effective date?

Staff does not believe it is necessary for the Commission to identify and detail a specific review process through this inquiry. The "process" for reviewing and approving property that becomes used and useful for service after the rate effective date can be established on a case-by-case basis, and in the Commission's order approving rates based on the property in question.

However, there should be some expectation that the company will report on the projects in question, and that parties will have an opportunity to audit project costs and make recommendations to the Commission with respect to whether those costs are appropriate for recovery. Utilities should be required to present sufficient testimony about the property they want included in rates and the methods, standards, formulas, or theories of valuation they used. The utility should be required to provide everything needed to audit the project and it should have to attest that the project has been placed in service and is providing benefit to ratepayers.

To the extent that, after review, costs are determined to be not appropriate for recovery, if the project costs are substantially different from the costs embedded in rates, if the in-service date was substantially delayed, or if the project was not placed in service during the rate effective

period, the associated revenues over-collected from customers should be subject to a refund, as part of a refund mechanism or other performance incentive such as revenue sharing.

Is this review process the same for plant placed in service both up to and during the rate-effective date?

Staff's understanding is that the review process identified in RCW 80.04.250(3) pertains only to plant "that becomes used and useful for service in this state after the rate effective date." Therefore, there is no legal requirement that the review process be applied to project placed in service after the test year but before the rate-effective period.

However, RCW 80.04.250(2) states that the Commission has power to determine the value for rate making purposes of the property used and useful for service by or during the rate effective period, indicating that a qualifying project placed in service after the test year but before the rate-effective period is appropriate to consider for inclusion in rates under the revised law. The Commission could require the same process for these projects as for projects placed in service after the rate effective period.

4. 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?

See response to Question 3, above. The Commission, if it so chooses, can use the same process for post-test year additions to rate base as it does to review plant that becomes used and useful after the rate effective period. Given that a GRC procedural schedule limits parties' ability to review and attest to projects placed in service beyond a certain date (such as beyond when response testimony is filed), Staff favors applying the process for reviewing qualifying plant that becomes used and useful after the rate effective period to qualifying plant placed in service before the rate year but after response testimony is filed.

What is the best way to incorporate the participation of all of the parties to the underlying rate proceeding in the process of reviewing the prudence of these post-test year plant additions?

The Commission could establish the review process for specific, qualifying investments in the final order of a GRC, and require the utility file a report on those investments in that GRC docket, thus allowing parties granted intervenor status to continue to participate.

5. 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?

As discussed elsewhere in these comments, Staff recommends that the Commission begin steering away from using statistical trending to calculate rate base for rate making purposes. As the Commission begins incorporating the review and approval of investment plans into its regulatory purview (such as with the CEIPs required by CETA), it will begin developing the foundation for a rate-setting process that relies on actual investments rather that mathematical extrapolations.

However, if the Commission advises that statistical trending of rate base is acceptable, the Commission must still identify a process for identifying, reviewing, and approving the property that becomes used and useful for service after the rate-effective date. Staff recommends the Commission neither require companies to simply verify the trended rate base level materialized nor require all projects transferred to plant after the rate effective date to be specifically identified and subject to review. The former encourages utilities to spend where they otherwise might not, and the latter becomes unwieldy to the reviewer.

If the level of rate base established by statistical escalation must be shown to be the level of rate base during the rate-effective period, the Commission creates an incentive for utilities to target a specific rate base rather than create value through business discipline. A utility conceivably could invest at a level lower than the statistical escalation rate, and to the extent that those investments were not strictly necessary in the first place ratepayers benefit over the long run through lower growth in utility rate base. Requiring that utilities verify they grew rate base consistent with a statistical trend discourages them from creating efficiency through business discipline.

If the specific investments a utility made to generate a level of rate base consistent with the statistical trend are subject to review and approval, the sheer number of investments at issue will hamper parties' ability to provide a thorough examination or a comprehensive recommendation to the Commission as it considers "approval," as is now required by statute. Consistent with how the Commission has traditionally considered pro forma plant adjustments, the Commission should establish criteria for projects subject to review pursuant to RCW 80.04.250(3).

How should actual plant-in-service relate to the plant-in-service used to establish rates?

As noted above, if the actual in-service date is later than the in-service date assumed for rates, some amount of utility revenues should be subject to refund.

For example, if rates assume project X is in service in month seven of the rate year, customers would be paying for project X for a half year. If in reality project X is not placed in service until month ten, customers will have paid for the project for three months when it was not used and useful for service. The modifications to the used-and-useful standard do not obviate the requirement that customers pay only for plant that is used and useful, and a delay in in-service date will have meant that they paid for plant that was not.