Small Business Economic Impact Statement (SBEIS)
Docket No. UG-990294

December __, 2000

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1. Introduction

In March 1999, the Washington Utilities and Transportation Commission (Commission) initiated a review of the rules in chapter 480-90 WAC regarding gas companies. The Commission initiated this review in Docket No. UG-990294 pursuant to Executive Order 97-02, which requires agencies to review existing rules for readability and content with attention being paid to clarity, intent, statutory authority, need, effectiveness, efficiency, coordination, cost, and fairness. Commission Staff also conducted a general revision of the rules to analyze whether they provided the results that they were originally intended to achieve and whether the rules are consistent with laws and with appropriate and lawful policies. New rules were added to ensure clear communication of policies, processes, and procedures or to provide complete information important to regulated companies and the customers they serve.

Over the last one and a half years, Commission Staff held four workshops with interested persons to discuss draft rule language, receive comments, and explore options. With the last formal draft rule, the Commission mailed a survey to interested persons to assist staff in preparing a Small Business Economic Impact Statement (SBEIS). An SBEIS is intended to evaluate any disproportionate impacts of the rule-making on small businesses.

2. Regulatory Fairness Act Requirements

Administrative rules implemented by State agencies can have a disproportionate impact on small businesses, compared to large business, simply because of the size of those businesses. This disproportionate impact may affect competition, innovation, employment, economic growth, and threaten the very existence of some small businesses. Thus, the Regulatory Fairness Act, chapter 19.85 RCW, was enacted with the intent of reducing any disproportionate impact of state administrative rules on small businesses.

The Regulatory Fairness Act requires agencies to prepare an SBEIS if the proposed rule will impose "more than minor costs on businesses in an industry." An agency must then compare the costs of compliance with the proposed rule for large and small businesses within an industry, and then consider how to mitigate any disproportionate impact on small businesses. A business is categorized as "small" under the Regulatory Fairness Act if the business employs 50 or fewer employees.

3. Background

Pursuant to chapter 19.85 RCW, Staff determined that it was necessary to prepare an SBEIS for gas rules in Docket No. UG-990294 as the proposed rules may impose more than minor costs on gas companies operating in Washington State. None of the gas companies operating in the state, however, fit the definition of "small" businesses under the Regulatory Fairness Act, and thus there is no requirement to consider mitigation proposals to minimize disproportionate impact on small businesses in the industry. Thus, Staff prepared the SBEIS in order to evaluate the magnitude of the economic impact of the proposed rules for chapter 480-90 on gas companies operating in Washington State, but not to propose mitigation strategies for small businesses.

4. Study Procedure

To perform the SBEIS, Staff prepared a survey instrument and mailed the survey to the four gas companies regulated by the Commission: Puget Sound Energy, Avista Corp., Northwest Natural Gas and Cascade. A copy of the survey is attached to this SBEIS as Attachment 1. Simultaneously, Staff prepared and mailed a survey to three electric companies to prepare an SBEIS in a rulemaking involving their operation in Washington State. Staff received completed surveys in Docket No. UG-990294 from two natural gas companies, one of which also operates as an electric company. The latter company combined its response to natural gas and electricity questions contained in the survey.

The four regulated gas companies are relatively large, and not considered "small businesses" for the purpose of this analysis. Because the Commission is not required to mitigate the economic impacts of the proposed rules on large businesses, large companies do not have great incentive to respond to the survey instrument or to provide detailed information. Staff believes that development of more comprehensive data would require an in-depth investigation of all activities of the companies and could take a significant amount of financial and human resources. Therefore, the results from this study should be interpreted with an understanding that the study is based upon very limited data.

5. Results of the Analysis

Two of the four gas companies responded to the survey mailed by the Commission. The two companies provided lump sum cost information that is difficult to disaggregate and verify. Determining whether the data supplied by the companies is correct would require an in-depth analysis and a breakdown of costs that would then be subjected to detailed analysis and peer review. Although Staff is concerned that the companies may have overestimated the costs of compliance with the proposed rules, Staff believes they are within a reasonable order-of-magnitude of the actual costs of compliance.

From the companies' perspective, the costs incurred to comply with regulations can be viewed as money that could have been invested in activities that bring greater earnings. An SBEIS is intended to examine the economic implications of the proposed rules from the companies' perspective as opposed to from a societal perspective. It is expected that companies would evaluate the economic impact of proposed rules by comparing earnings from spending amounts equal to the regulatory compliance cost of "X" dollars in different activities. The source of funds for these expenditures might be retained earnings or borrowed money. Accordingly, to capture the volatility in earnings from alternative forms of investment, Staff used a range of discount factors (9%, 10%, 10.5% and 11%) to estimate the present alternative value of the estimated spending on regulatory costs by the companies.

A review of pertinent literature concerning the economic impact of regulation indicates that if the increased (additional) costs of regulatory compliance exceed approximately 2% of the total operating expenses of a business, the cost of regulation is likely to be significant to that business. Staff used this benchmark (i.e., 2%) to draw conclusions about the magnitude of the economic impact of implementing the rules proposed in Docket No. UG-990294.

The estimated cost of compliance submitted by the companies is based on data from records, interviews, and experience, rather than from a detailed on-site study of the impact of each rule. Empirical evidence derived from this kind of information is considered to be an order-of-magnitude estimate. The literature on the study of engineering-economics indicates that order-of-magnitude estimates are accurate within ±40%. The 2% rule of thumb indicated above is thus better stated as a range from 1.2% to 2.8% (i.e., 2%*40%=.8%;2%- .8%=1.2%; 2% + .8% = 2.8%).

Staff's evaluation of the magnitude of the compliance costs submitted by the companies is set forth below in Table 1. The results indicate that the percentage of the present value of the cost of implementing the rules with respect to the present value of gross operating revenue (GOR) and total operating expense (TOE) for the gas companies is 0.01%. The results also indicate that, on average, the costs imposed as a result of these rules are in fact not only within ±40% of the 2% benchmark obtained from the literature with respect to the economic impact of regulations, but are much less than 2%.

Table 1: Summary of the Impacts of the Proposed Rules on Natural Gas Companies

	Discount Factors				**Average**
Parameters	**9%**	**10%**	**10.50%**	**11%**	
Compliance Cost	$1,532	$1,379	$1,314	$1,200	$1,356
Overall company cost	21,576,892	19,424,037	18,500,819	16,894,512	$19,099,065
Gross Operating revenue	24,361,999	21,931,257	20,888,872	19,075,226	$21,564,339
Net Revenue	2,785,107	2,507,221	2,388,053	2,180,714	$2,465,274
Cost /Gross Operating revenue	0.01%	0.01%	0.01%	0.01%	0.01%
Cost/Overall Company cost	0.01%	0.01%	0.01%	0.01%	0.01%
Total cost/Overall Net Revenue	0.06%	0.06%	0.06%	0.06%	0.06%
Total cost of rules/employee	$3	$3	$3	$3	$0
Total cost of rules/customer	$0.01	$0.01	$0.01	$0.01	$0.00
Total cost of rules/customer	$0.15	$0.14	$0.13	$0.15	$1,532

The proposed rules are intended to provide for safe, adequate, and efficient gas service as well as to define the rights and responsibilities of gas company customers. Thus, the proposed rule may have not only economic costs and benefits, but social costs and benefits. The social costs and benefits of implementing the proposed rules need to be based on the principle of incremental costs and benefits.

In order to assess the social costs and benefits of these proposed rules, it is important to assess which components of these costs are passed on to customers, and which ones are shareholder costs. However, due to time and resource constraints it is not possible to determine the social costs of implementing the proposed rules. Staff believes that the rules generate welfare gains (benefits) to society as a whole, as well as financial benefits to the regulated companies. However, the companies did not provide any measurable estimated benefits attributed to the implementation of these rules. Thus, it is difficult to compare the social and economic costs and benefits of implementing the proposed rules. Nevertheless, Staff believes that implementation of the proposed rules will to generate social benefits that are at least equal to the estimated costs of compliance.

In summary, 1) even if the costs of regulatory compliance with the proposed rules have not been overestimated by the companies responding to Staff's survey, the economic costs of compliance remain negligible, 2) the changes in rules are expected to generate substantial benefits that cannot be readily quantified, and thus not compared with estimated compliance costs, 3) although it was not possible to directly compare the costs and benefits of implementing the proposed rules, Staff believes that the benefits of implementing the proposed rules related to public health, safety, and fairness are at least equal to the costs of compliance, and 4) there is no need for the Commission to consider mitigation or other relief measures because the costs are negligible, and there are no small businesses affected by the proposed rules.

6. Conclusion

Chapter 19.85 RCW requires that a SBEIS be prepared to assess whether the proposed rules more than minor costs on businesses in an industry," in this case, gas companies. Staff mailed surveys designed to obtain information about the cost of compliance with the proposed rules to all four natural gas companies regulated by the Commission. Staff received responses from two companies.

Staff reviewed pertinent literature, and relied on benchmarks suggested in the literature to determine whether the regulatory costs reported by the companies are considered to be significant. Staff believes that the cost data submitted by the companies overestimate the costs of compliance. Nevertheless, Staff's analysis indicates that the estimated compliance costs provided by the companies are negligible when compared with total operating costs and revenues. Staff's analysis indicates that implementing the proposed rules should not affect the viability of the large gas companies operating in the State of Washington, nor customers served by these companies.