

Service Date: January 31, 2020

**BEFORE THE WASHINGTON
UTILITIES AND TRANSPORTATION COMMISSION**

In the Matter of the Commission Inquiry
into the Valuation of Public Service
Company Property that Becomes Used
and Useful after Rate Effective Date

DOCKET U-190531

POLICY STATEMENT ON
PROPERTY THAT BECOMES USED
AND USEFUL AFTER RATE
EFFECTIVE DATE

- 1 In 2019, the Washington State Legislature passed Engrossed Second Substitute Senate Bill 5116 (E2SSB 5116), the Clean Energy Transformation Act, relating to the clean energy transition of electric utilities in Washington.¹ Section 20 of E2SSB 5116 amends RCW 80.04.250, Valuation of public service property—Authority of commission, and requires the Washington Utilities and Transportation Commission (Commission) to “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 The Commission subsequently conducted an inquiry into the appropriate process for identifying, reviewing, and approving public service company property that becomes used and useful for service in Washington after the effective date of a proposed rate. The Commission issues this Policy Statement pursuant to RCW 34.05.230 and WAC 480-07-920 to provide guidance to regulated companies regarding that process.

I. HISTORY, BACKGROUND, AND LEGAL CONTEXT

- 3 Since 1933,¹ the statute governing the valuation of utility property has required this Commission and its predecessor agencies to “ascertain and determine the fair value . . . of the property of any public service company used and useful for service in this state.”² In

¹ The version of the valuation statute in effect prior to 1933 differed from the modern version because it was significantly more prescriptive with regard to which property the public service commission must value in setting rates, *compare* LAWS OF 1911, ch. 117, § 92 *with* LAWS OF 1933, ch. 165, § 4, to ensure compliance with then-prevailing Supreme Court precedent concerning the rate regulation of public service companies. *State ex rel. City of Spokane v. Kuykendall*, 119 Wash. 107, 116, 205 P. 3 (1922) (citing *Smyth v. Ames*, 169 U.S. 466, 18 S. Ct. 418, 42 L. Ed. 2d 819 (1898)).

² LAWS OF 1933, ch. 165, § 4. Between 1933 and 2018, the legislature substantively amended the valuation statute on two occasions. LAWS OF 2011, ch. 214, § 9; LAWS OF 1991, ch. 122, § 2.

its penultimate iteration, codified at former RCW 80.04.250 (2012), the valuation statute provided that:

The commission has the power upon complaint or 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 and shall exercise such power whenever it deems such valuation or determination necessary or proper under any of the provisions of this title. In determining what property is used and useful for providing electric, gas, wastewater company services, or water service, the commission may include the reasonable costs of construction work in progress to the extent that the commission finds that inclusion is in the public interest.³

- 4 In 2018, the Washington State Court of Appeals, Division Two (Court of Appeals) interpreted former RCW 80.04.250 as part of its review on appeal of the Commission’s final order in Avista Corporation’s (Avista) 2015 general rate case (GRC). At issue in the appeal was the Commission’s approval of attrition adjustments to Avista’s electric and natural gas rate bases,⁴ which were calculated using statistical escalation of plant balances.⁵ The Court of Appeals held that the “projected data” involved in the escalations “[w]as not tied to any particular used and useful plant,” and reversed and remanded the matter to the Commission to recalculate Avista’s rates without relying on rate base that was not used and useful.⁶
- 5 The Commission argued before the Court of Appeals that property is used and useful if it provides benefits and is in service “in the period during which rates may reasonably be expected to be in effect.”⁷ The Court of Appeals rejected that argument based on an opinion issued by the Washington Supreme Court that stated the “property on which a

Both of these amendments permitted the Commission to value plant under construction and not yet in service for certain utility companies, partly abrogating the Washington Supreme Court’s opinion in *People’s Org. for Wash. Energy Res. v. Wash. Utils. & Transp. Comm’n*, 101 Wn.2d 425, 679 P.2d 922 (1984).

³ LAWS OF 2011, ch. 14, § 9.

⁴ *Wash. Att’y Gen.’s Office v. Wash. Utils. & Transp. Comm’n*, 4 Wn. App. 2d 657, 659, 686, 423 P.3d 861 (2018).

⁵ *Id.* at 665-68.

⁶ *Id.* at 687-89.

⁷ *Id.* at 687-88 (quoting Br. of Resp’t at 31-32 (quoting James J. Hoecker, Used and Useful, Autopsy of a Ratemaking Policy, 8 Energy L. J. 303, 312 (1987))) (emphasis omitted)).

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public utility is entitled to earn a fair return is that which is used and useful for public service at the time the inquiry as to rates is made.”⁸

- 6 The Court of Appeals’ opinion cast doubt on some of the Commission’s ratemaking practices, including attrition adjustments and multi-year rate plans.⁹ In its 2019 session, the legislature clarified the Commission’s ratemaking authority by enacting E2SSB 5116,¹⁰ which provides, in relevant part, that:

(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. 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.

(3) 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. *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.¹¹

- 7 These 2019 amendments address the Court of Appeals’ decision in two ways. First, by authorizing the Commission to provide for changes to rates up to four years 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,”¹² the legislature allows the Commission flexibility in establishing rate base, including for adjustments involving statistical escalations such as those at issue in Avista’s 2015 GRC. Second, by stating that

⁸ *Id.* at 688 (quoting *People’s Org. for Wash. Energy Res.*, 104 Wn.2d 798, 815, 711 P.2d 319 (1985)) (emphasis added).

⁹ *Cf.* LAWS OF 2019, ch. 288, § 1(5) (confirming that the Commission’s “statutory grant of authority for rate making includes consideration and implementation of performance and incentive-based regulation, multiyear rate plans, and other flexible regulatory mechanisms.”).

¹⁰ *Id.*

¹¹ *Id.* at § 20 (emphasis added).

¹² LAWS OF 2019, ch. 288, § 20(3).

the Commission may value property “used and useful for service in this state by or during the rate effective period,”¹³ the legislature permits the Commission to value property placed in service after “the inquiry as to rates is made.”¹⁴ To value such property, however, 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.”¹⁵

- 8 Significantly, the legislature did not alter the “used and useful standard” itself. Consequently, for the Commission to value the property of a public service company, that property must be “employed for service in Washington and capable of being put to use for service” at some point during the rate effective period.¹⁶
- 9 This Policy Statement addresses in detail the process by which the Commission will identify, review, and approve public service company property that becomes used and useful for service in this state on or after the rate effective date.

II. COMMENTS AND RESPONSES

- 10 On July 5, 2019, the Commission issued a Notice of Opportunity to File Written Comments on the appropriate process for identifying, reviewing, and approving property that becomes used and useful on or after a rate effective date. By August 5, 2019, the Commission received written comments from eight stakeholders in this docket.¹⁷
- 11 We appreciate the feedback provided by all of the commenters, and incorporate into our statement of policy in Section III, below, a number of concepts and recommendations offered by stakeholders. Stakeholders provided constructive comments about the need to differentiate types of ratemaking adjustments, *i.e.*, investments that are used and useful within the test year, those that meet the requirements for a pro forma adjustment, and those that will become used and useful during the rate effective period. Stakeholders also discussed that capital investments, and the evidentiary support for those investments, may

¹³ *Id.* at § 20(2).

¹⁴ *Wash. Att’y Gen.’s Office*, 4 Wn. App. 2d at 688 (quoting *People’s Org. for Wash. Energy Res.*, 104 Wn.2d at 815).

¹⁵ LAWS OF 2019, ch. 288, § 20(3).

¹⁶ *People’s Org. for Wash. Energy Res.*, 101 Wn.2d at 430 (emphasis omitted).

¹⁷ The Commission received comments from eight stakeholders: the Public Counsel Unit of the Attorney General’s Office, the Alliance of Western Energy Consumers, Avista Corporation, Cascade Natural Gas Company, Northwest Natural Gas Company, Pacific Power and Light Company, Puget Sound Energy, and Commission Staff.

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vary depending on the type of investment, such as whether they are specific,¹⁸ programmatic,¹⁹ or projected.²⁰

12 In particular, and relevant to the process that is the subject of this Policy Statement, various stakeholders recommended the Commission avoid an overly prescriptive approach and maintain its flexibility, while also emphasizing the importance of the Commission's existing ratemaking standards. Stakeholders also suggested the Commission allow rates to become effective subject to refund in certain circumstances, such as when authorizing multi-year rate plans, and further suggested a retrospective evaluation process that would allow parties a reasonable opportunity to review and challenge the recovery of any investments placed in service during the rate effective period. We embrace each of these concepts in this Policy Statement.

13 Nevertheless, we decline to adopt a number of stakeholder suggestions for the reasons discussed below. Specifically, we do not agree that:

1. The Commission should move beyond statistical trending of rate base;
2. Changes to RCW 80.04.250 require updates to our current rules and regulatory standards; and
3. The revised used and useful standard is only applicable in the context of a multi-year rate plan.

14 Although all stakeholders agree that rate base projections are permitted by law, not all agree that the Commission should use rate base forecasts for ratemaking purposes. Specifically, Public Counsel and Commission staff (Staff) recommend the Commission include in rates only specifically identified investments.

15 We decline to limit our ratemaking authority in the manner that Staff and Public Counsel propose. RCW 80.04.250(1) specifically states that its provisions are "necessary to ensure that the Commission has sufficiently flexible authority to determine the value of utility property for ratemaking purposes...." RCW 80.04.250(3) further states that the Commission may provide changes to rates for up to 48 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." This language permits the

¹⁸ Specific means a clearly defined, identifiable or discrete investment (*e.g.*, generating asset, etc.).

¹⁹ Programmatic investments are, by their very nature, investments made according to a schedule, plan, or method such as the replacement of power poles or other small distribution system investments necessary to provide safe and reliable service to Washington ratepayers.

²⁰ Examples include but are not limited to: the use of a k-factor, an attrition adjustment, or a growth analysis.

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Commission to set rates based on statistical escalation, and we have recognized that such escalations may be appropriate in some circumstances when supported by the record.²¹

16 We also decline to adopt Staff’s proposal to identify parameters for assessing whether a prospective plant investment qualifies for inclusion in rates. Although we appreciate Staff’s view, setting such limitations would unnecessarily restrict our statutory authority. As discussed further below, and in keeping with various stakeholder comments, the Commission will consider proposals related to three broad types of investments: specific, programmatic, and projected.

17 Staff also argues that because the recent changes to RCW 80.04.250 affect our current rules and regulatory standards, those rules and standards should be updated or addressed in this Policy Statement. For example, Staff argues that, because the statute now explicitly allows for rate plans of up to 48 months, the “known and measurable” standard must be modified to accommodate property included in rates but not yet in service. We respectfully disagree. As we discuss in detail below, the Commission’s existing standards remain applicable. For property not yet in service, these standards will be critical to the Commission’s retrospective review of the property in question.

18 We also respectfully disagree with Public Counsel’s argument that the revised used and useful standard is applicable only in the context of a multi-year rate plan. The valuation statute allows the Commission to incorporate into rates property that becomes used and useful after the rate-effective date, even in the absence of a multi-year rate plan. As discussed below, multi-year rate plans will be addressed in a separate docket.

III. POLICY GUIDANCE

A. Scope

19 This Policy Statement addresses only the process the Commission will use to value property (investment or plant) that is, or will become, used and useful by or during the rate effective period under the Laws of 2019, chapter 288, section 20, subsections 2 and 3, which are now codified as RCW 80.04.250(2) and (3). The rate effective period can encompass a single year, a multi-year rate plan (up to 48 months), or any single year within a multi-year rate plan. This Policy Statement does not address separate issues related to the Commission’s authority to consider and implement performance and incentive-based regulation, multi-year rate plans, and other flexible regulatory

²¹ See, e.g., *Wash. Utils. & Transp. Comm’n v. Avista Corp. d/b/a Avista Utils.*, Docket Nos. UE-160228 & UG-160229, Order 06 (Dec. 15, 2016).

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mechanisms. Those issues will be addressed in Docket U-180907 once the various rulemakings required by the Laws of 2019, chapter 288 are completed.²²

20 This Policy Statement affirms – and requires that regulated companies include and consider in their proposals – the Commission’s longstanding practices regarding property placed in service. These practices require companies to show that the property will be used and useful;²³ that proposed pro forma adjustments to test year amounts will involve known and measurable events and adhere to the matching principle (*i.e.*, the principle that costs should be matched to offsetting factors)²⁴, including accounting for all offsetting factors;²⁵ and that costs were prudently incurred.²⁶ In traditional ratemaking, we decide these issues prior to the rate effective date. With this Policy Statement, we establish a process for the provisional recovery in rates of rate-effective period property, subject to refund, where the property, investment or project in question does not meet the current standards for inclusion in rates prior to rates becoming effective. Under this process, we make our final decision on rate recovery in a future period after sufficient information about the property in question has become available.

²² On November 8, 2018, the Commission issued a Notice of Inquiry into the Adequacy of the Current Regulatory Framework Employed by the Commission in Addressing Developing Industry Trends, New Technologies, and Public Policy Affecting the Utility Sector in Docket U-180907, which is the appropriate docket for considering issues related to alternative forms of regulation.

²³ See *People’s Org. for Wash. Energy Res.*, 101 Wn.2d at 430 (holding that for property to be used and useful it must be “employed for service in Washington and capable of being put to use for service in Washington”).

²⁴ The matching principle for the purposes of this Policy Statement means the net effect of including an investment with related offsetting factors. In other words, the matching principle requires that all factors affecting a proposed pro forma adjustment (or proposed provisional pro forma adjustment) include pro forma level (or provisional pro forma level) revenue, rate base, and expense.

The Commission recognizes that the matching principle is also a generally accepted accounting concept that requires companies to recognize (match) revenues earned to related expenses in the same period.

²⁵ WAC 480-07-510(3)(c)(ii). Offsetting factors include, but are not limited to, removing rate-year retirements, dispositions, and non-depreciating plant, including revenue growth, and operations and maintenance (O&M) expense offsets. Without incorporating these offsetting factors, a proposal will not be considered to be in the public interest because resulting rates would not be fair, just, reasonable, and sufficient, as required by RCW 80.28.010(1).

²⁶ *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 307-12, 109 S. Ct. 609, 102 L. Ed. 2d 646 (1989) (discussing the constitutional permissibility of the prudent investment method of rate base valuation); see *People’s Org. for Wash. Energy Res.*, 104 Wn.2d at 810 (discussing the Commission’s power to disallow imprudent utility costs).

B. Currently Applicable Commission Principles and Standards

- 21 As noted above, the Commission’s longstanding ratemaking practice is to set rates using a modified historical test year with post-test-year rate-base adjustments using the known and measurable standard, the matching principle, and the used and useful standard, all while exercising considerable discretion under each of these standards in the context of individual cases. We intend to continue following these practices and standards as we implement the change to how and when we evaluate property as used and useful. It continues to be necessary within the context of a GRC to first develop a modified historical test year (*i.e.*, pro forma study) upon which requests to include property in rates will be considered. The Commission will continue to rely on a modified historical test year to evaluate the relationships among revenues, expenses, and investments to ensure their proper matching.
- 22 WAC 480-07-510(3)(c)(ii), which defines pro forma adjustments, remains unchanged, applicable, and relevant. In particular, this rule defines the known and measurable standard and the offsetting factors standard, both of which are elements of the matching principle, and both of which are necessary to ensure that costs and offsetting benefits are accounted for during the period in which they occur. The known and measurable standard continues to require that an event that causes a change to revenue, expenses, or rate base must be “known” to have occurred during or after the historical 12-months of actual results of operations.²⁷ It must also be demonstrated (*i.e.*, known) that the effect of the event will be in place during the rate year.²⁸
- 23 The actual amount of the change must be also be “measurable.” This has historically meant that the amount cannot be an estimate, projection, product of a budget forecast, or some similar exercise of informed judgment concerning future revenue, expense, or rate base. The Commission previously has made exceptions, such as when it considered the use of attrition adjustments and power cost modeling forecasts when determining whether rates are just, reasonable, and sufficient, pursuant to RCW 80.28.020.²⁹

²⁷ *Wash. Utils. & Transp. Comm’n v. Avista Corp. d/b/a Avista Utils.*, Docket Nos. UE-090134 & UG-090135, Order 10, 21 ¶ 45 (Dec. 9, 2009).

²⁸ The Commission has in past orders identified that the effect of the event must be known within the rate year (*i.e.*, a twelve month period). *Wash. Utils. & Transp. Comm’n v. Avista Corp. d/b/a Avista Utils.*, Docket Nos. UE-090134 & UG-090135, Order 10, 21, ¶ 45 (Dec. 22, 2009). However, the rule simply requires that “Pro forma adjustments give effect for the test period to all known and measurable changes that are not offset by other factors.” It does not establish one rate year as a limiting factor. In this Policy Statement, we interpret that this period can be multiple rate years (up to 48-months) based on current statute RCW 80.04.250(3).

²⁹ *Wash. Utils. & Transp. Comm’n v. Avista Corp. d/b/a Avista Utils.*, Docket Nos. UE-090134 & UG-090135, Order 10, 21 ¶ 49 (Dec. 22, 2009) (hereinafter “Order 10”) (power cost modeling);

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- 24 The Commission’s longstanding practice of using the matching principle continues to require netting of known and measurable changes with any offsetting factors that diminish the impact of the known and measurable event.³⁰ Including post-test-year plant in rates without considering these offsetting factors creates a mismatch that overstates the effect of the known and measurable event, thus distorting the rate-year relationship among revenues, expenses, and rate base.
- 25 As currently applied, the less certainty with which actual utility costs and offsetting factors are known and measurable, the greater the risk that a pro forma adjustment will disturb test-year relationships and call into question whether a traditional pro forma plant adjustment is appropriate.³¹ The Commission must assess the certainty with which costs and offsetting factors are known when it balances the competing pressures to change test-year values to reflect newer information with preserving the integrity of the test year.³² The further a proposed adjustment considered in a GRC occurs from the end of the test year, the less time Staff and other parties have to review a company’s supporting evidence. In light of these factors, the company’s burden to demonstrate that it has met the requirements guiding adjustments to test-year data is greater.³³
- 26 The Commission’s longstanding interpretation of the property valuation provision of RCW 80.04.250 is that property or plant additions must be used and useful to serve Washington customers to be included in rates.³⁴ “Used” means that the investment (plant) is in service, and “useful” means that a company has demonstrated that its investment benefits Washington ratepayers.³⁵ With few exceptions, the Commission has required plant to be in service no later than the suspended effective date to be included in rate

Wash. Utils. & Transp. Comm’n v. Avista Corp. d/b/a Avista Utils., Docket Nos. UE-120436 & UG-120437 (consolidated), and UE-110876 & UG-110877 (consolidated), Order 09/14, 26-28 ¶¶ 70-73 (Dec. 26, 2012) (attrition adjustment).

³⁰ Order 10 at 21 ¶ 46.

³¹ The Commission applies this same concept to pro forma adjustments related to rate year investment request based on current statute RCW 80.04.250(3).

³² The Commission applies the same balancing concept to rate year investment requests based on current statute RCW 80.04.250(3).

³³ Order 10 at 21 ¶ 47 & n.45.

³⁴ The Commission also examines whether the new plant has been prudently built or acquired. The Commission’s prudence analysis examines many factors, including whether the costs asserted are reasonable compared to other alternatives a company considered at the time the decision to build or acquire was made. A company must support its decision with sufficient evidence. *See UTC v. Puget Sound Power & Light Co.*, Docket Nos. UE-920433, UE-920499, & UE-921262, 11th Supplemental Order, at 18-24 (Sept. 21, 1993).

³⁵ *Wash. Utils. & Transp. Comm’n v. PacifiCorp d/b/a Pac. Power & Light Co.*, Docket UE-130043, Order 05, 31 ¶ 79 (Dec. 4, 2013).

base. Typically, that meant plant would be in service before the tariff revisions become effective, which generally marks the beginning of the rate year.³⁶ Changes to RCW 80.04.250(3), however, permit the valuation of property that becomes used and useful up to 48 months after the rate-effective date, provided that it is both placed in service and benefitting customers in Washington within the prescribed timeframe.

- 27 With the changes to RCW 80.04.250(3), we find that the requirements for pro forma adjustments discussed above hold true for requests for rate-effective period property, although they cannot be reviewed completely prior to rates going into effect. Accordingly, we must replace the traditional prospective review with a retrospective review for rate-effective period property requests.

C. Commission Policy on Used and Useful Property

- 28 The amended statute does not guarantee recovery of specific, programmatic, or projected plant; rather, it enables the Commission to provide opportunities for utilities to seek more timely recovery of plant investments while otherwise operating consistent with existing Commission rules, principles, standards, and case precedent. In doing so, we intend to achieve four goals:

- (1) Ensure general consistency with longstanding ratemaking practices, principles, and standards;
- (2) Maintain flexibility;
- (3) Avoid overly prescriptive guidance; and
- (4) Support streamlined processes by requiring additional process only when necessary.

- 29 The Commission will consider rate-effective period investment recovery requests that are consistent with its longstanding ratemaking practices and standards. These standards will be applied retrospectively during the review process. The Commission will exclude, disallow, or require refunds of money recovered for proposed rate-effective period capital-plant additions that lack proper evidentiary support, including the identification of offsetting factors and documentation that the property in question is in fact used *and* useful. The Commission also will reject requests that either cannot be audited or are unreasonably burdensome to review. In adhering to this general standard, the Commission seeks to strike a balance of the public service companies' and ratepayers' interests by providing a reasonable opportunity for parties to perform a meaningful review.

³⁶ Order 10, 22 ¶ 48.

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- 30 While the application of longstanding ratemaking practices, principles, and standards necessarily constrains the substance of requests for a given plant investment that the Commission finds will become used and useful within 48 months of the rate effective date, the Commission will remain flexible by assessing whether those requests are appropriate and reasonable on a case-by-case basis. But for exceptional circumstances, however, the Commission intends to use its standard processes for identifying property for ratemaking purposes, for reviewing and approving that property under the used and useful standard and the known and measurable standard, and for determining prudence.
- 31 By issuing this Policy Statement, we seek to provide guidance without being overly prescriptive. As discussed further in the Process section, below, the Commission will also be flexible in allowing companies to file requests identified as either specific, programmatic, or projected property investments.
- 32 The Commission encourages regulated companies to streamline their requests by using existing reporting frameworks and limiting additional or duplicative processes. For example, a request is not “streamlined” if it creates unnecessary or burdensome processes. The Commission also encourages companies to use existing or future reporting to inform requests and aid in the Commission’s and other parties’ review. Such reports must include or expand upon information necessary to enable observation of ongoing rate-effective period investment if that information is not already required.

D. Process Overview

- 33 Attachment A contains two flow charts that provide a preliminary overview of the Commission’s process related to either an annual review or review in the context of a company’s next GRC. These simple flow charts are intended to provide high-level illustration of the review processes for property that becomes used and useful after the rate-effective date. Moreover, the charts should not be construed as suggesting the Commission’s preference for, or the validity of, one particular method of identifying, reviewing, or approving rate-effective period property over another.

1. Identification of Investments

- 34 The amended statute grants the Commission broad authority, and we decline to prescribe here a specific approach for identifying rate-effective period investment. The Commission will continue, however, to require regulated companies to provide specific information at the time a request is filed. Companies must first identify rate-effective period investment either through a GRC or another appropriate process.³⁷ Companies

³⁷ Public service companies may file, and the Commission may approve, investment plans for identifying specific or programmatic rate-effective period investment (*e.g.*, clean energy

must then propose rate-effective period investments identified through a GRC separately from traditional pro forma rate-base adjustments through the use of a provisional pro forma adjustment, and then must state whether they are seeking recovery through base rates or a separate tariff schedule. Next, companies must include the estimated or projected costs (including all offsetting factors and duplicative recovery considerations) and a description of the investment, as well as other existing documentation, for a project that will be subject to review and audit during a future period. Finally, companies must provide the expected in-service date that will occur during the rate effective period.³⁸

35 The threshold for including provisional pro forma adjustments will be determined on a case-by-case basis according to the specifications of the rate-effective period investment. For example, there is a greater degree of certainty that an investment is known and measurable if it is part of an approved Clean Energy Implementation Plan. For programmatic investments, however, utilities should demonstrate their spending through historical trends related to the specific program (*e.g.*, wood pole replacement over the last 10 years). The evidentiary standard for purely projected investments will require information regarding the level of spending, cost controls, and the specific need for the projected investment.³⁹

36 Identifying when an investment will become used and useful is an important consideration for determining provisional rates, particularly within the context of a multi-year rate plan. For example, if an investment will become used and useful in year one of the rate-effective period, then provisional rates that include this investment may be effective in the beginning of rate-effective period year one. If the rate-effective period investment will become used and useful in year two of a multi-year rate plan, then provisional rates that include this investment may be effective in the beginning of year two. The same would be true for years three and four of a multi-year rate plan.

37 When a company identifies property for recovery that will become used and useful in the rate-effective period, it must also separately identify all offsetting factors. Proposals to identify rate-effective period investments that use projections must not come

implementation plans, distribution plans, or individual investments) either within a GRC or in separate proceedings where the Commission first considers the investment plans (or specific investment). Proposals can also include investment plans related to WAC 480-100-505 (Smart grid technology report).

³⁸ If a company's request includes a multi-year investment roll-out period of up to 48 months, the company must provide all in-service dates within the proposed roll-out period. Companies are discouraged from filing their next GRC during their proposed multi-year investment roll-out period because this would unnecessarily complicate ratemaking processes and defeat the purpose of the Commission allowing provisional recovery of rate-effective period investment.

³⁹ Prudence is always part of the investment threshold question and is continuously evaluated during the life of an investment.

Operating and Maintenance expense (O&M), rate base, and offsetting factors, because such comingling would restrict other parties' ability to review the appropriateness of investment recovery and propose recommended refunds, and also would restrict a company's ability to use separate tariffs. When companies use projections for seeking recovery of investment in the rate effective period, the Commission will consider these proposals viable only if the projections employ identifiable and distinct escalation factors, are supported by clear, easily comprehensible models, and separately demonstrate offsetting factors.

38 Although the Commission may allow in rates property that is not placed in service until after the rate-effective date, in most cases the Commission will not confirm or verify such property as known and measurable, used and useful, or otherwise conforming to the Commission's ratemaking standards before the property is included in rates. As a result, review and verification of these investments must occur in a future period, necessitating a framework of provisional recovery of identified rate-effective period investments, with a retrospective review and verification process, and with rates subject to refund. We discuss this further in the section below.

2. *Review of Investments*

39 The Commission's longstanding practice is to audit and review the prudence of a company's investment in plant after the plant is placed into service. Regulated companies bear the burden of proving that their investment decisions are prudent, just as they are required to demonstrate that their proposed rates are just, reasonable, and reflect capital expenditures that are used and useful to ratepayers.⁴⁰

40 The general framework for review of provisional pro forma adjustments requires that:

- Companies will provide sufficient information to facilitate the review, including a prudence review, by Staff or other parties;
- Each party should have the flexibility to propose the structure of its own review, including preferred audit protocols where appropriate;
- Parties will continue to be afforded due process (including receiving notice and sufficient time for review); and
- The Commission will provide an opportunity for hearing as necessary, depending on the level of controversy.

⁴⁰ RCW 80.04.130(4) provides that "[a]t any hearing involving any change in any schedule, classification, rule, or regulation the effect of which is to increase any rate, charge, rental, or toll theretofore charged, the burden of proof to show that such increase is just and reasonable shall be upon the public service company."

- 41 The review process for provisional pro forma adjustments will confirm that a company has placed property in service on or near the projected in-service date, and will address the accuracy and validity of any estimated (*i.e.*, known and measurable) costs and offsetting factors. Companies must document known and measurable costs by actual expenditure, invoice, contract, or other specific obligation. During the review, costs that continue to be the product of forecasts, projections, or budgets, are not supported by documentation, or that are otherwise not shown to be used and useful will not qualify for inclusion in rates, and must be refunded. The Commission's standards for review and approval of capital investment in rates remain unchanged in that regard.
- 42 Review of rate-effective period investment will depend on a company's request and the type of identified property. The review will not, however, simply be a matter of matching identified rate base to the rate base provided in rate-year Commission Basis Reports. The review process must provide adequate opportunity for parties to review, and, if necessary, challenge the recovery of provisional pro forma adjustments previously included in rates. The timing of the review will depend on the form and in-service dates provided in the identification process.⁴¹ The identified rate-effective period investment will be reviewed (and final approval determined) either annually or biennially, or in a company's next GRC. At a minimum, annual reporting (or progress reports) will be necessary when the period between the effective date of provisional rates and the final review is more than one year. In all cases, a company must provide and make available all relevant data and information to support its initial investment request and its claim that the actual investment was placed in service.

3. *Approval of Investments*

- 43 The Commission is obligated by statute to set rates that are fair, just, reasonable, and sufficient by balancing the public's need for safe, reliable, and appropriately priced service with a regulated company's financial ability to provide that service. The recent changes to RCW 80.04.250 must be exercised consistently with our primary obligation to regulate in the public interest. Thus, the resulting rates must be fair to both customers and the public service company; just, in that the rates are based solely on the record following the principles of due process of law; reasonable, in light of the range of potential

⁴¹ If a rate plan is approved that includes projections of rate base, those rates related to projected rate base will be subject to refund. The Commission will require the utility to file another GRC at the conclusion of the rate plan in which parties will have the opportunity to review rate base over the multi-year timeframe.

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outcomes presented in the record; and sufficient, to meet the financial needs of the company to cover its expenses and attract capital on reasonable terms.⁴²

- 44 All rate-effective period investments included in rates will be subject to refund because these investments are identified *ex ante*. The Commission's standards, however, can only be applied *ex post*. The Commission does not view allowing companies to recover costs of future plant subject to refund as a pre-approval of the prudence of the investment, nor does it view an order to refund as inconsistent with its obligations under the used and useful standard. As discussed in the Scope and Review sections, rate-effective period investments will still be held to the same standards, rules, and law applicable at the time of review, and it is a company's burden to support its case and prove that its investments are prudent.
- 45 Any rate-effective period investment amounts found during the review process not to be used and useful, known and measurable, adequately matched to offsetting factors, and prudently incurred, will be refunded to customers. The Commission will consider different approaches to return these refunds to ratepayers, including whether to assess interest. Finally, the Commission will not allow companies to assess surcharges for amounts claimed to be under-recovered during the rate-effective period. If identified investment costs exceed what the regulated company is collecting from customers based on its proposed, estimated, or projected costs, the Company may file an accounting petition.
- 46 In sum, this Policy Statement establishes a two-step approval process. The first step involves provisional approval for the inclusion in rates of identified rate-effective period investment. The second step involves final approval after the investments are reviewed and confirmed to be used and useful and prudent. Property granted provisional approval, with rates subject to refund, can either be embedded in base rates or recovered through a separate tariff schedule. The utilization of separate tariff rates provides for simplified recovery and avoids the risk of subjecting base rates to refund. Notwithstanding the manner in which the rates are implemented, the review process must be completed prior to a company filing its next GRC, unless the order granting provisional recovery allows the review to occur within the company's next GRC proceeding.
- 47 We strongly encourage companies to develop their proposals in accordance with this guidance and consistent with existing precedent, standards, rules, and laws. We also

⁴² See generally *Fed. Power Comm'n v. Hope Nat. Gas Co.*, 320 U.S. 591, 64 S. Ct. 281, 88 L. Ed. 333 (1944); *Bluefield Water Works & Improvement Co. v. Pub. Serv. Comm'n of W.V.*, 262 U.S. 679, 43 S. Ct. 675, 67 L. Ed. 1176 (1923); *People's Org. for Wash. Energy Res.*, 104 Wn.2d at 807-13 (describing the rate setting process in Washington).

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encourage companies to work with stakeholders to eliminate unnecessary controversy or confusion prior to filing any requests for recovery of rate-effective period investments.

48 The Commission issues this Policy Statement pursuant to RCW 34.05.230 and WAC 480-07-920. This statement contains guidance to regulated companies seeking recovery of property that becomes used and useful during the rate-effective period, which RCW 80.04.250(3) allows to extend up to 48 months after the rate-effective date. This Policy Statement does not constitute an order binding upon either the Commission or the parties that may come before it in formal proceedings, nor is this Policy Statement an enforceable rule.

DATED at Lacey, Washington, and effective January 31, 2020.

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

DAVID W. DANNER, Chairman

ANN E. RENDAHL, Commissioner

JAY M. BALASBAS, Commissioner