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VIA E-MAIL

Steven V. King
Executive Director and Secretary
Washington Utilities and Transportation Commission
1300 S. Evergreen Park Dr. S.W.
PO Box 47250
Olympia, WA 98504-7250

RE: Investigation of Possible Ratemaking Mechanisms to Address Utility Earnings Attrition
Docket U-150040
Comments of the Northwest Industrial Gas Users

Dear Mr. King:

These comments are being submitted on behalf of the Northwest Industrial Gas Users ("NWIGU"). NWIGU has actively participated in recent ratemaking dockets in which earnings attrition has been a central issue. NWIGU appreciates the opportunity to continue being involved in these discussions and to assist the Commission with its investigation. These comments respond to the specific questions presented in the Notice dated February 5, 2015.

At the outset, NWIGU would like to express its continued support for the Commission's use of an historical test year for purposes of general ratemaking. The Notice does not separately inquire whether a utility or stakeholder prefers the use of such a test year, but that question is contained in one of the questions in the Notice, and one's view on that issue certainly shapes the response to any of the other questions.

The fundamental principle of ratemaking is that rates should provide the utility with a reasonable opportunity to recover the costs incurred for providing service. The best measure of a utility's costs is an analysis of the actual, verifiable costs it incurs, which can only be determined by the use of an historical test year. A future test year, in contrast, requires rates to be based on budgeted amounts, which are necessarily speculative. To be sure, each type of test year can lead to earnings that differ from those on which rates are based; the historical test year might, under certain conditions, result in regulatory lag or attrition, and a future test year might result in overearnings or accretion. However, consumers have greater protections under the historical test

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year method. The utility is in the best position to know whether its earnings are in line with rates. When a utility is underearning, it can easily file a new rate case and demonstrate a need for higher rates. When a utility is overearning, however, there is little to compel the utility to file for a rate reduction.

The above-described fundamentals of ratemaking and the historical test year serve as the basis for NWIGU's answers to each of the following questions stated in the Notice.

1) Your organization's perspective on the cause(s) of utility earnings attrition, e.g., high inflation, aggressive capital investment in infrastructure, low/no load growth.

A utility's earnings can be impacted by changes in its cost of service that are either within or outside of utility management control. Each change must always be reviewed on a case-by-case basis, because a decline in earnings in one area does not necessarily mean that the utility's overall earnings are eroding. Revenue increases due to growth in customers and sales, for example, can offset cost increases resulting from aggressive capital investment. Further, factors such as reductions in operating costs, changes in "net" utility capital investment (including rate base reductions from deprecation) and technological improvements in providing service may cause reductions in the cost of providing utility service and defer or eliminate the need to increase rates due to increased costs for any particular line item.

There is also a difference in the predictability in the potential drivers of reduced earnings. Inflation, for example, while able to be forecast, is not predictable in the sense that its extent will ever be known in advance. Aggressive capital investment, on the other hand, is largely known well in advance. Such investments are either part of a utility's resource planning efforts, or they are part of the normal course of business, such as replacing aging infrastructure. Even new investments required to be made from changes in regulations typically do not come as a surprise.

Because utility earnings can be impacted by such a myriad of factors, which both increase and decrease earnings, the most balanced and reasonable method of adjusting utility prices is to consider all costs and revenues within a general rate case.

2) Your organization's preferred ratemaking mechanism(s) for addressing each of the forms of earnings attrition identified in (1) above, e.g., an attrition allowance, pro forma plant in rate base, construction work in progress (CWIP) in rate base, or future test year. Please include a discussion of the benefits and shortcomings of your preferred mechanism and of alternative mechanisms. Also discuss whether the different causes of attrition require different ratemaking solutions, in your respective view.

The most balanced and accurate method of setting utility rates is to reflect all known and measurable revenues and costs within a rate case to establish tariff charges which are no higher than necessary to provide the utility full cost recovery and a reasonable opportunity to earn a fair return on its investment in utility plant and equipment. Traditional utility ratemaking practices provide economic incentives for utility managers to aggressively manage costs to earn a fair rate of return at the rates approved by the Commission. Imbalanced attrition methods of setting rates eliminate or reduce the utility management incentive to manage the costs at the approved utility prices. NWIGU therefore opposes attrition methodologies because they can erode management's economic incentive to aggressively manage costs to make the utility more efficient, and can skew the practice of setting just and reasonable rates. Further, utility earnings can be managed by filing rate proceedings.

NWIGU believes traditional ratemaking practices in Washington have resulted in just and reasonable prices for utility customers, and has supported credit and access to capital for Washington utilities. This proven practice has met the objective of balanced rate-setting practices and fair treatment of both customers and shareholders. This methodology should continue to be used in both an outlook for increasing cost of service, and decreasing cost of service, just as it has successfully been implemented for decades.

NWIGU notes that some natural gas utilities in Washington have gone without a rate case for many years while other utilities have filed for frequent rate changes. The utilities that forego rate increases typically are those that are not investing significantly in utility plant and equipment. For these utilities, it is customers that bear the burden of regulatory lag because utility rates are not reduced to reflect flat to declining rate base amounts in the face of increasing customers and corresponding sales. Conversely, utilities in a cycle of large capital investments generally file frequent rate cases. These utilities adjust rates to reflect greater amounts of invested capital and rate base. During times of heavy investment, a utility may be impacted by regulatory lag, but the Commission has on multiple occasions concluded that such lag is an acceptable part of ratemaking. Further, regulatory lag can be mitigated by management practices or filing new rate cases. The Commission has also made efforts to decrease the impact of that potential lag through tools such as pro forma adjustments or the use of end-of-period rate base.

Washington's traditional regulatory mechanisms are balanced and fair. The regulatory lag symmetrically impacts both the utility and customers in terms of adjusting rates to reflect changes to utilities' cost of service. However, traditional ratemaking has a proven track record as evidenced by consistent maintenance of investment grade bond ratings by utility companies, which have supported access to large amounts of capital at low cost for utility infrastructure investments. With a balanced perspective of regulatory lag, and a successful track record, it simply is unnecessary and unjust to implement an attrition mechanism into traditional ratemaking. An attrition mechanism will tilt the current balanced treatment for investors and customers in traditional regulatory practices in favor of investors, which is unnecessary and unjust.

3) *If your organization prefers the Commission adhere to a historical test year ratemaking approach, please discuss why it would or not it would be appropriate to consider potential earnings attrition in that historical year context.*

As noted above, NWIGU does prefer that the Commission adhere to an historical test year ratemaking approach. Earnings attrition is inconsistent with use of a historical test period to base rates on known and measurable costs. Earnings attritions are projected costs, which are highly uncertain and not known and measurable. Earning attrition adjustments to the historical test year therefore introduce costs which simply do not meet the normal standard in setting rates to ensure rates reflect only reasonable and prudent costs of service.

NWIGU would not oppose, under certain circumstances, the use of known and measurable adjustments to historical test year costs, or approaches that reflect costs which can be verified and proven in post-test year adjustments to an historical period. However, a critical element to any type of adjustment is to have verifiable and demonstrable evidence that the utility's costs will actually increase. A utility simply providing a budget reflecting increases is not verifiable, nor is it shown to be just and reasonable. As such, projections of increased cost of service must unequivocally prove that they are measurable and legitimate projected increases in cost of service.

4) *If your organization has a preferred mechanism(s), please discuss the requirements and parameters necessary for calculating the adjustment(s). Please include in your comments responses to the following questions:*
   a. *Should an attrition analysis include historical data only?*

Yes. Historical costs can be verified and shown to be just and reasonable. Projected costs are highly uncertain, and may or may not be actually incurred.

b. *Should rate-year capital budgets be considered?*

NWIGU would consider the use of capital budgets, under certain circumstances. Any such consideration must include an assurance that capital costs in the budget will actually be made and that costs will be reasonable and prudent. Highly uncertain projections of capital investments are not appropriate and do not meet a known and measurable standard in setting cost-based rates.

c. *Should there be a "bright-line" cutoff date for including pro forma plant in rate base?*

Yes. While the capital investment must be a known and measurable change to the utility's cost of service, there should be a clear delineation in how far beyond the implementation of rates projected capital additions will occur. Going too far beyond the test year will ignore changes in a utility's cost structure that may offset in whole or in part the projected cost increase, and as a result, overstate the utility's cost of service.

d. *What level of precision should be expected for projected capital budgets (budgeted to actual) for ratemaking?*

NWIGU believes there should be a reasonably high level of precision when comparing revenues to actual cost of service in designing rates. Utilities are fully compensated for the uncertainty of whether or not rates and sales will materialize to provide full consideration of their cost of service. This operating risk has been in existence for decades, and utilities have been able to operate within that level of investment risk, still attract capital in reasonable amounts, and attract capital at reasonable costs.

NWIGU intends to participate fully in this docket and will be available to the Commission during the work session in April.

Sincerely,

Chad M. Stokes
Tommy Brooks

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