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Via UTC Web Portal

Mark L. Johnson
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Washington Utilities & Transportation Commission
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COMMISSION

RE: Docket U-180907 – Comments of Cascade Natural Gas Corporation

Dear Mr. Johnson,

Cascade Natural Gas Corporation (“Cascade or Company”) responds to the questions presented in the Washington Utilities and Transportation Commission’s (“Commission”) “Notice of Opportunity to File Written Comments” (“Notice”),¹ by respectfully submitting the following comments for the Commission’s consideration.

Introduction

First, Cascade very much appreciates the Commission’s ongoing review of its current regulatory framework and its expressed interest in creating a regulatory environment that supports and protects the interests of ratepayers, regulated utilities, and the many stakeholders and statutory parties that participate in the Commission’s processes and proceedings. Cascade welcomes this opportunity to express its views on the Commission’s existing practices and its

¹ The Commission’s Notice was filed in Docket U-180907 on December 17, 2018.

opinions on how such practices can be improved without drastically altering the Commission's regulatory framework.

Cascade believes the foundation for Commission ratemaking decisions should be the acknowledgment and consideration of expenses and revenues expected to be incurred after the test year. This would not require a fundamental change to the Commission's current practices and methodologies. Rather, existing ratemaking practices, such as pro forma accounting adjustments, could be expanded without disregarding the basic principles of ratemaking.²

From Cascade's perspective, the Commission should strive to set rates based upon its most accurate assessment of a company's expected expenses and revenues during the rate year.³ When the drivers of costs or revenues are expected to increase or even vary materially in future periods, the use of historical costs and circumstances dictated by a company's past history will not produce accurate and meaningful results for setting rates.

In closing, the Commission acts to set rates that are "fair, just, reasonable and sufficient"⁴ by balancing the interests of the regulated utility and its ratepayers. As the Commission is aware, electric and natural gas utilities are experiencing conditions and circumstances that materially impact the ratemaking process and potentially disrupt the equitable balance between a company and its ratepayers. Cascade's current regulatory situation represents such a circumstance.

1. Please identify the problem statements and principles that are important to you or your constituency. Please indicate which problems are the most important to address during this process and which principles are most important to consider when developing potential solutions.

² For example, the Commission allows projected power and natural gas costs into rates, in part based upon the unreliability of using historic costs to set future rates, subject to the demonstrated accuracy of the forecasts and future review.

³ Clearly, the accuracy of the expense assessment would be dependent upon the period under review. Said another way, the most accurate knowledge of an expense is at or near the time the expense is incurred.

⁴ See, RCW 80.28.010(1)

The relationship between Cascade's capital spending and its return *of* and *on* its invested capital is askew. As a result, Cascade's earnings in Washington have fallen short of authorized for several years, largely due to the under-recovery of capital investments made to improve the reliability and efficiency of its distribution system.⁵ Operating under the existing regulatory framework, the Company will continue to under-earn into the next decade and constantly be playing catch up in order to produce revenues sufficient to recover its capital costs and expenses. This all too familiar circumstance is the by-product of strict adherence to certain practices limiting Commission consideration of investments and expenses incurred after the "test year" and the regulatory lag allowed by the Commission's statutory framework.⁶

Cascade and other regulated companies that face increases in unrecovered expenses and capital costs have only one tool in their regulatory toolbox – to file rate cases year over year until a reasonable balance between revenues and costs can be achieved. This is the situation now facing Cascade and it will be required to file annual rate cases through 2022 and beyond in order to reasonably recover its costs and produce earnings at or near its authorized returns. Stated as a principle, the Commission's regulatory practices and processes should be flexible enough to allow reasonable and timely cost recovery during periods marked by changing circumstances and exceptional system requirements.

Considering the impacts of its current situation, Cascade's future regulatory requirements are driven by more than simply increasing earnings and are inclusive of the needs of its customers and the Commission. To this end, Cascade is committed to improving the reliability and efficiency of its distribution system. Ratepayers benefit from such improvements upon

⁵ Cascade's current ROR is 7.35%, as established by the Commission in Docket UG-151286, Order 04, dated July 7, 2016.

⁶ See, RCW 80.04.130(1).

completion and for perhaps decades after the initial investment is made by the Company. Stated as a principle, the ratepayers and Cascade should see benefits from the functions of the Commission's regulatory framework.

The equitable balance⁷ between Cascade and its ratepayers should allow the Company the opportunity to recover its costs within a reasonable period after such costs are incurred. But, when the statutory suspension period is applied, the Commission cannot even consider, let alone balance, the equities until the case is presented for decision – perhaps as long as 12-22 months after the expenses and investments are incurred.⁸ A long delay before potential cost recovery, particularly when new invested capital exceeds current depreciation expenses, tips the equity balance away from scale center to favor the Company's ratepayers. Stated as a principle, the Commission's practices and procedures should encourage the reasonable and timely recovery of Cascade's capital investments and expenses.

Cascade understands that regulatory lag creates an incentive for the Company to ensure economic efficiency between rate orders. However, it is also clear that the benefits from such an incentive can be outweighed by the costs to the Company, Commission, and parties, incurred when general rate cases are filed, prosecuted, analyzed and decided. When high-cost cases are filed year over year by the same company and with issues largely unchanged, neither ratepayers nor the company benefit. In fact, it could be said that ratepayers, who are ultimately responsible for rate case expenses, are harmed by the cost of recurring rate cases.

In the end, regulatory lag should be avoided as the preferred outcome for any party. In fact, it should not be considered an outcome at all, as it is an *effect* resulting from operation of

⁷ As noted above, the Commission balances the interests of ratepayers and the serving utility when setting rates and deciding other matters impacting utility service.

⁸ The period between filing and a final order is generally dependent upon the period between the end of the test year and filing, and the period between the date of filing and the Commission's final order.

the statute. The true outcome of a rate case is the Commission's order – an order that balances the interests of all parties to the case.⁹ Stated as a principle, the Commission's regulatory framework should effectively and reasonably balance the interests of the Company and its ratepayers.

Finally, the outcomes resulting from this docket that modify or otherwise condition the Commission's existing ratemaking practices and processes should be clearly enunciated by way of an Interpretive and Policy Statement or a rulemaking and order that sets forth the Commission's intent, determined solutions, and timeline for implementation.¹⁰ Such clarity of purpose and resolution will avoid predictable disputes over the methods or conditions determined by the Commission as necessary to set “just, fair, reasonable, and sufficient” rates.

To close, the principles enunciated above are repeated below:

- The Commission's regulatory practices and processes should be flexible enough to allow reasonable and timely cost recovery during periods marked by changing circumstances and exceptional system requirements.
- Cascade and its ratepayers should see benefits from the function of the Commission's regulatory framework.
- The Commission's practices and procedures should encourage the reasonable and timely recovery of Cascade's capital investments and expenses.
- The Commission's regulatory framework should effectively and reasonably balance the interests of the Company and its ratepayers.

⁹ When considering general economic tenets, customers make more rational and responsive decisions when facing the actual cost of the delivered service.

¹⁰ See, RCW 34.05.230

- The Commission's existing ratemaking practices and processes should be clearly enunciated by way of an Interpretive and Policy Statement or a rulemaking and final order that sets forth the Commission's intent, determined solutions, and timeline for implementation.
- 2. During the December 10, 2018, workshop, stakeholders identified several potential principles to guide the Commission's consideration of alternatives to the current regulatory framework, including, among others, net customer benefits, equity, alignment of customer and utility incentives, universal access, safety, reliability, affordability, customer choice, innovation, environmental protection, and alignment with state policies. Please provide comments on problem statements and principles raised by other stakeholders during the workshop and provided in pre-filed comments, and discuss their importance to you or your constituency.**

As noted above, Cascade's projected capital spending into the next decade will continue and possibly exacerbate its current cycle of under-recovery of costs and under-earning in Washington. Given its circumstances, the Company believes it must file annual general rate cases through 2022 and perhaps beyond to reasonably recover its expenses and capital costs. However, Cascade also believes that the deployment of regulatory tools designed to recognize expenses and capital investments incurred after the test year could avoid the necessity of filing annual rate cases.

Therefore, the remainder of these comments will focus on such regulatory tools, including end of period and pro forma accounting for expenses and capital investments, acceptance of demonstrable changes in expenses and revenues occurring in the rate year, the recognition of capital investments made in the rate year and beyond, so long as the company demonstrates the project is in service and meets the Commission's prudence requirements, multi-year rate plans incorporating the general requirements demonstrating necessity of cost incurrence and prudence, and interim rates. These are described in more detail below.

End of Period and Pro Forma Accounting Adjustments

To begin, the Commission's use of end of period accounting is allowed and at time used to set rates.¹¹ However, it is not fully sanctioned by the Commission for more extensive use by utilities facing cost recovery risks associated with the Commission's Modified Historical or "Hybrid Test Year."¹² Rather, a recent statement on regulation makes clear that regulatory "tools" must be shown to be appropriate for a company's individual circumstances.¹³ To this point, Cascade understands the Commission's reluctance to accept end of period accounting as the preferred successor for determining test year expenses and revenues. However, it encourages the Commission to provide guidance more specific than that expressed in its recent 2016 order. Said more colloquially, without such guidance the support currently needed for demonstrating the appropriateness of end of period accounting feels more like the legendary "bring me a rock" test than a clearly stated set of principles guiding companies considering the adjustment.

Expressed as examples, does the Commission believe that end of period accounting should only be allowed when a company demonstrates a likelihood of under-earning without the adjustment? Or, is the accounting tool acceptable when it can be demonstrated that a company's expenses and revenues more accurately reflect the actual financial circumstances facing the utility at the end of the test year?¹⁴

Since each of the above "tests" are based on independent but related regulatory objectives, it would be helpful for the Commission to articulate the threshold standard(s) it

¹¹ See, *WUTC v. Avista Corporation*, Dockets UE-160228 and UG-160229 (consolidated), Order 06 at p.44 (December 15, 2016).

¹² *Ibid.* at 48.

¹³ *Ibid.* at 49. ("Whatever tools are proposed for use in a given case, however, must be chosen with specific reference to the needs of the case and the appropriateness of using each tool selected must be demonstrated by applicable evidence.")

¹⁴ These examples represent but two possible uses of an "end of period" adjustment and are not meant to exclude other possible rationales for its use. Further, both examples would assume that the "matching" principles are applied, and their requirements met.

would accept to set rates using end of period accounting. By establishing such a standard(s), the Commission would provide needed clarity and possibly avoid the contests typically arising when an end of period adjustment is presented.

From Cascade's perspective, both examples can be justified, as they are grounded on fundamental ratemaking principles: the "end result" should provide a reasonable opportunity to earn the Commission's approved return; and, rates should be based on accurate representations of a company's financial condition. No matter the threshold(s), the real benefit to the Company would be a clear articulation of the circumstances in which an end of period adjustment could be used to set rates.

Cascade also recommends that pro forma adjustments be more liberally used to include changes to expenses and revenues incurred after the test year. Specifically, Cascade recommends that material changes to expenses and capital investments incurred after the initial rate case filing be recognized by the Commission and included in rates.¹⁵ As to the latter, Cascade recommends that application of the adjustment be broadened to include capital investments representing the aggregation of general, distribution level, capital investments, without limiting such investments to individual "major projects."¹⁶

To this point, Cascade's capital plant investments involve the replacement or new construction of distribution plant. Individually, these projects would not qualify as "major projects," but in aggregate the Company's capital investment is equal to that expended by the electric companies to build certain distribution-level facilities, such as transformers or transmission extensions that could be treated as "major projects." This disparity of treatment can

¹⁵ Cascade recognizes that material changes in expenses and capital investments would have to be made known to the Commission in time to allow Staff and parties the opportunity to review and analyze the subject expenses.

¹⁶ See, *Wash. Utils. & Transp. Comm'n. v. Pacific Power & Light Co.*, Docket UE-140762, Order 08, ¶ 152 (March 25, 2015).

be remedied by amending the Commission's rules to treat aggregated costs for system-wide developments as a single initiative that would qualify as a "major project."¹⁷

Cascade's recommendations here would not require a fundamental change to the Commission's current practices and methodologies. Rather, existing ratemaking practices can be made more flexible, accommodating the current and future circumstances facing regulated energy companies. If these changes are allowed by the Commission, Cascade believes that set rates will more likely reflect the Company's actual expenses and revenues and better balance the interests of Cascade and its ratepayers.

Changing Rates When Rate Year Expenses and Revenues Deviate from Test Year Evidence

Cascade encourages the Commission to expand the recommendations expressed above to include material changes to expenses and revenues expected during the rate year, with the exception of capital investments that are discussed in the following section.

Cascade can foresee the potential for post-test year cost increases related to labor and personnel, health care, pension requirements, cost of debt, and increased inflation.¹⁸ Importantly, the Company would have little or no control over the market and regulatory forces driving such cost increases. Should these cost centers materially impact the Company's revenues and earnings in the rate year, the Commission should consider cost recovery options designed to mitigate the financial impacts to the Company. Such recovery mechanisms could include deferred accounting, expedited rate filings, or the revision of rates on a defined schedule established by the final order. For the latter option, a company would be required to demonstrate

¹⁷ See, *Wash. Utils. & Transp. Comm'n. v. Avista Corp.*, Dockets UE-150204/UG-150205, Order 05, ¶ 40 (Jan. 6, 2016).

¹⁸ These cost areas are meant as examples and not be exclusive of other potential causes of cost increases.

the likelihood of such rate-year cost increases as part of its rate case.¹⁹ Cascade believes the availability of rate-year recovery options could mitigate the need for annual general rate cases.

Changing Rates to Include Capital Investments Incurred After the Final Order

As articulated above, Cascade's timely recovery of capital investments made to improve the reliability and efficiency of its distribution system would likely produce earnings reasonably sufficient to avoid annual rate cases. However, the timely recovery of invested capital has proven elusive.

The Company believes that the current regulatory framework when coupled with its annual investment in distribution system improvements, leaves it little choice but to file annual rate cases into the next decade. Regrettably, this pattern of recurring rate cases has proven to be exhausting to the Commission and all participants.²⁰ Cascade believes that a regulatory mechanism designed to recognize capital investments made during the rate year and beyond could successfully avoid the burden created by the filing of annual rate cases.

To begin, Cascade believes that a properly designed capital investment recovery mechanism should be administratively efficient and allow all parties and stakeholders the opportunity to participate.

As to the design itself, Cascade believes the mechanism should be narrowly focused on capital projects aligned by common objectives and design features. This would enable more efficient Commission review of the included projects. For Cascade, the mechanism would be

¹⁹ Cascade assumes that costs identified for future recovery in the rate case would be demonstrated to be "known and measurable" either in the rate case or when presented for recovery in the rate year. Further, the Company assumes that changes to rates would not result in over-earning.

²⁰ See, *Wash. Utils. & Transp. Comm'n v. Puget Sound Energy*, Dockets UE-121697 and UG-121705 (*consolidated*) and Dockets UE-130137 and UG-130138 (*consolidated*), Order 07, ¶ 21 (June 25, 2013).

designed around recovery of its capital spending to improve the reliability of its distribution system.

Next, the mechanism's design would be structured to emulate deferred accounting mechanisms previously approved by the Commission. The design would require an annual filing that details the projects completed since the last filing and accounts for all deferred costs, including return *on* and *of* its capital invested capital. To this end, the annual filing would present evidence demonstrating that the included projects meet the Commission's requirements for inclusion in rate base, including a showing that the projects are providing service to ratepayers.²¹ .

Cascade also proposes that the mechanism's design require a general rate case filing within four years of the order approving it.²² At that time, the Commission would review whether the mechanism had met its objectives and would continue to deliver practical and useful results for the Commission and the Company into the future. During the "pilot" phase of the mechanism's introduction, its design should not be altered, barring a showing of unintended consequences or harm. This condition would allow the Commission to better assess the efficacy of the mechanism's core design features during the "pilot" phase and help assure a reasonable level of administrative efficiency when under Commission review.

Finally, Cascade recommends that its rate of return shall not exceed the level most recently authorized by the Commission during the "pilot" period. To this point, the Company recognizes that its current earnings sharing mechanism allows for a sharing of earnings above the

²¹ See, RCW 80.28.250.

²² The four-year period would effectively set general rates for up to five years, assuming the case filed after the "pilot" period would be suspended and set for hearing.

authorized rate of return. During the “pilot” phase Cascade would propose all earnings above the authorized rate of return be returned to customers.

In sum, the approval of Cascade’s proposed capital project recovery mechanism would avoid the Company’s need to file annual rate cases by allowing it to recover capital costs incurred to improve the reliability of its distribution system. The mechanism’s design offers a balance between the interests of the Company and its ratepayers, while promoting incentives within Cascade to control costs between rate cases and saving the Commission, Company, ratepayers and all parties the cost of prosecuting, defending, and deciding frequently filed rate cases.

Multi-Year Rate Plans

Cascade strongly supports the Commission’s efforts to articulate multi-year rate plan designs that can be incorporated into its current regulatory framework, and to explore ideas of modifying the framework to accommodate current circumstances and pressures facing companies and ratepayers alike. Clearly, the prospect of multi-year rate plans covering the broad spectrum of utility operations holds great promise as a tool to avoid recurring rate cases. In fact, Cascade’s proposed capital cost recovery mechanism described above emulates a hybrid multi-year rate plan built around recovery of a narrow range of investment costs.

The Commission currently employs numerous regulatory mechanisms that should delay utility decisions to file rate cases to recover costs, including deferred accounting, power and natural gas cost recovery mechanisms, revenue decoupling, and Power Cost Only Rate Cases. In each of these mechanisms, the Commission has allowed more timely cost recovery without unfairly tipping the balance between ratepayers and utilities. However, none of the above

regulatory mechanisms allow a company to change future rates without Commission review and action.

Given its regulatory framework, it is difficult for the Commission to change rates in future periods without some form of review and a determination that the new rates are “just, fair, reasonable, and sufficient.” To reach an evidentiary finding supporting changes to base rates, the Commission would be required to rely upon studies forecasting a company’s costs and revenues over a future period. However, the use of forecasts to set future rates has proven problematic given questions about reliability.

As to reliability, the accuracy of a forecast diminishes over the length of the period involved. Thus, a forecast looking ahead five years is generally less accurate than a forecast looking ahead one year. Hence, the requirement to submit next period forecasts for power or natural gas costs and to file Integrated Resources Plans built around future forecasts every two years.

Without question, the Commission can set rates based upon future forecasts, but the most common mechanisms used today require the Commission to periodically review actual expenses and adjust rates as needed. Therefore, it appears to Cascade that the existing regulatory framework allows the Commission little flexibility when considering future changes to base rates based solely upon forecasts, unless some contemporaneous review of the actual costs and revenues supports the rate change.²³

Given the above, Cascade makes two recommendations. First, if the Commission were to retain the existing regulatory framework, then multi-year rate plans based upon forecasted expenses and revenues should incorporate a review of actual expenses and revenues into the

²³ Such a review would likely meet the requirements of RCW 80.04.250.

mechanism. The timing of the review would be determined by the proposed changes in rates called for in the final order. Next, if the Commission were to entertain a more radical departure from current practices, it would state a preference for rates based upon future test years and engage in a rulemaking to establish the requirements for general rate case filings supported by future test years. Cascade expresses no philosophical preference for either option in this filing and does not view the choice as being zero sum, as it would make sense to allow multi-year rate plans as an interim measure while developing the principles applicable to future test years.

Interim Rate Relief

The above regulatory relief mechanisms are intended as tools to mitigate the negative economic impacts of regulatory lag, without detrimentally impacting the Commission's review and analysis of the core issues presented in a rate case. They are not, however, intended to be a substitute for one another. In other words, the more liberal use of pro forma accounting in a particular matter should not bar the Commission from also considering longer-term rate relief solutions to reach that matter's end result.²⁴ Similarly, interim rate relief is also available to the Commission to reach an end result that effectively addresses a company's financial circumstances, including the impacts of persistent regulatory lag.

Interim rate relief is a tool that is currently available to the Commission, taking the forms of temporary and emergency rate relief. To this end, the Commission has the power "... to regulate in the public interest [and] may, when it deems it justified, fix a temporary rate to be charged by a utility pending a valuation of the utility's property and the determination of a reasonable rate."²⁵ While such temporary relief is commonly granted in solid waste and water

²⁴ The Company's proposed capital project cost recovery mechanism represents such a longer-term solution.

²⁵ See, *Washington Util. & Transp. Comm'n v. Pacific Northwest Bell Tel. Co.*, Cause No. U-72-30 at 5, Second Supp. Order (1972). See also, *State ex rel. Puget Sound Navigation Co. v. Department of Transportation*, 33 Wn.2d 448, 482, 206 P.2d 456 (1949).

utility matters, the Commission's broad authority to set temporary rates for gas and electric utilities has been narrowed to dealing with financial emergencies.²⁶ Cascade believes this narrow interpretation of the Commission's powers is unnecessarily restrictive and should be reexamined and expanded to include the mitigation of persistent regulatory lag.

To this end, Cascade recommends the Commission allow utilities the opportunity to request interim rates, subject to refund, to be effective thirty days after initial filing of a general rate case. The interim rates should be based on test period results after restating adjustments and limited to no more than seventy-five (75) percent of the total rate request. The interim rates should also be based on the lower of the current authorized rate of return or requested rate of return. Cascade believes the subject to refund provision allows the Commission (and parties) ample time to fully analyze all test period costs, hold a hearing, and compare the interim relief to the final Commission ordered results. From Cascade's perspective, no refund would be due unless the final rates set by the Commission are lower than the interim rates.

In closing, Cascade appreciates the Commission's commitment to address these important issues and would welcome any questions regarding the ratemaking principles and mechanisms expressed herein. Please refer all questions to Michael Parvinen at 509-734-4593 or at michael.parvinen@cngc.com.

Sincerely,

/s/ Michael Parvinen

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²⁶ See, *In re the Matter of Avista Corporation, d/b/a Avista Utilities*, Docket No. UE-010395, Sixth Supplemental Order (2001).