Exhibit ___ (JMR-6)
Docket No. UG-060266, et al.
Witness: James M. Russell

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, **Complainant,** **v.** **PUGET SOUND ENERGY, INC.** **Respondent.**	**DOCKET NO. UG-060266** **DOCKET NO. UE-060267** ***(consolidated)***

EXHIBIT OF

JAMES M. RUSSELL

STAFF OF THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

Commission Order on Summary Attrition

July 25, 2006

U-72-30 PNB

ATTRITION

The attrition factor is an innovation in the company's rate base presentation. The company contends that attrition is caused by the addition of plant at a higher unit cost than cost of similar items in the rate base used to establish service rates and therefore the company should be compensated therefor. The attrition factor is calculated as follows: Average cost per telephone as of December 31, 1972, $486; additional cost of new stations, $971; leaving a difference of $485 per station added; multiply by the estimated increase in net telephones between May 16, 1973 and June 30, 1974, 81,110; equals $39,338,000. The attrition figures recited by Mr. Desmond refers to total operations for the State of Washington without separation for intrastate. Mr. Kerr's intrastate attrition allowance after separation amounts to $29,570,000.

Inflation is a recognized fact of economic life and in setting rates for the future the inflationary impact is indeed recognized not only in the cost of plant but also in the increased cost of money required to produce new plants.

Inflation and the expectation of inflation must have influenced investors for the prices they paid for common stock and debt capital and the terms on which they were willing to invest their money. If then investors' expectation as to the future do determine the cost of capital to reflect it again by the use of an attrition factor would amount to an unwarranted duplication and would in effect not only protect the equity investor against inflation, but would in fact make him a beneficiary thereof.

Rising costs are recognized in the adjustments made in results of operation and the increased cost of the rate base on the one hand and the rate of return on the other. Each bears a balancing relationship to the other.

We are not the recipients of sufficient evidence to convince us that the rate of return is being jeopardized by spiraling inflationary factors that aren't accommodated for in the determination of the rate of return.

U-74-14 PNB

The Commission finds the so-called earnings erosion adjustment in the amount of $2,405,000 urged by PNB totally without justification. This proposed adjustment is identical to the rate base attrition adjustment first proposed by the Company in Cause U-72-30 and therein rejected. It is appropriate to restate the observations made by the Commission then:

> Inflation is a recognized fact of economic life and in setting rates for the future the inflationary impact is indeed recognized not only in the cost of plant but also in the increased cost of money required to produce new plants.
>
> Inflation and the expectation of inflation must have influenced investors for the prices they paid for common stock and debt capital and the terms on which they were willing to invest their money. If then investors' expectation as to the future do determine the cost of capital to reflect it again by the use of an attrition factor would amount to an unwarranted duplication and would
>
> in effect not only protect the equity investor against inflation, but would in fact make him a beneficiary thereof.
>
> Rising costs are recognized in the adjustments made in results of operation and the increased cost of the rate base on the one hand and the rate of return on the other. Each bears a balancing relationship to the other.
>
> We are not the recipients of sufficient evidence to convince us that the rate of return is being jeopardized by spiraling inflationary factors that aren't accommodated for in the determination of the rate of return. (Cause U-72-30 at pp. 22-27)

The record shows that Company total telephones are increasing; total revenue, disregarding effects of rate cases, is increasing both absolutely and relative to telephone added. Total operating revenue is increasing significantly more than the consumer price index. In short, the record does not support a theory of significant earnings erosion for PNB. The Company essentially projects an earnings erosion through 1975, largely based upon what it views as a continuing "frantic" inflation level. Yet current events indicate that the accelerated level of inflation experienced in 1974 is being slowed by deepening recession. Passing time has shown the Commission correct in rejecting the attrition adjustment in Cause No. U-72-30, the amount of the adjustment then urged by PNB has proved to have been overstated. The Company has not yet met the burden of demonstrating the necessity of such an extraordinary, prospective and subjective adjustment.

U-81-17 PPL

E. Minimum Attrition Adjustment. After making its year-end adjustments, respondent added a minimum attrition adjustment to items of revenue, expense, and rate base to bring those items to the levels presented in the company's forecast of calendar year 1981. The adjustment is rejected as susceptible to the same errors and lack of verification as the forecasted test period.

U-81-41 PSPL

F. Attrition Adjustment

During periods of relative economic stability, a test year analysis produces valid information not in a measurement of the level of various expenses during the test period, but in the relationships between revenues and expenses. A properly adjusted test period under those conditions will in the time following the analysis show a relatively constant relationship which will permit company operations to proceed on a relatively stable basis with relatively satisfactory funding.

In recent years, rapid inflation has caused company expenses to rise disproportionately to revenues. Under these circumstances, rates which are set at a given level with reference to an adjusted test period are insufficient to keep pace with the expenses driven upward by inflationary pressures.

This Commission, as have other Commissions, has searched for mechanisms to deal with the problem of meeting inflationary pressures. In other cases we have considered various mechanisms, including end-of-period test year analysis and "attrition adjustments" which purport to raise various financial elements beyond the end of the test period to account for experienced or expected inflationary pressures.

In this proceeding, we recognize financial attrition and authorize the respondent to consider in rates the effects of issues of debt and preferred stock which will not occur until months following the issuance of our order. In addition, the discounted cash flow analysis of equity also recognizes the inflationary expectations of investors to the extent that those expectations of inflation require compensation.

Both the company and the staff recommend attrition allowances in this proceeding by which various of the company costs are inflated to levels which the proponent of the adjustment foresees as likely in the medium-term future.

The staff, through witness Louiselle, presents an attrition adjustment of about $7.6 million at the net operating income

level. The company agrees with the staff, but suggests additional adjustments which, including a power supply attrition adjustment, bring the total requested company attrition adjustment up to nearly $15 million. We have above treated the power cost attrition issue and will not further speak to it.

For several reasons, as to this company in its present circumstances, we reject the requested adjustments.

First, the company's recent actual results of operations demonstrate that it is keeping pace with recent levels of inflation and is in fact improving its operating results. Recent economic measures undertaken by the federal government have led to a substantial slackening of inflation to the point where near-term future inflation levels may not be accurately predicted by recent term past inflationary levels and the attrition estimates of the witnesses may be significantly higher than the actual levels to be experienced.

Unrebutted testimony by numerous members of the public gives us substantial reason to believe that serious efforts at improving efficiencies and at achieving economies in day-to-day operations would produce substantial results for the respondent. While we do not accept as truth the public fear that the company considers ratepayers to be a money machine removing all need for cost consciousness, we do believe that an attrition adjustment would tend to dampen management incentive to achieve efficiencies in staff and in use of other resources.

Under the circumstances of this case, we believe that it is proper to deny the requested attrition adjustments in light of recent positive company performance, recent trends toward the abatement of inflation and the effect of such an adjustment to reduce substantially management incentive to achieve efficiencies in operation.

U-82-10 WWP

V. ATTRITION ALLOWANCE

An attrition allowance is based upon the probability that changes will occur in revenues, expenses and rate base from the end of the adjusted period to a determined future date.

Both the company and the Commission staff included an attrition allowance in the revenue requirement for the period December 31, 1982, to October 1983. The company's attrition allowance would result in a decrease in NOI of $12,532,000, producing a gross revenue deficiency for the test period of $36,929,000. However, as stated elsewhere in this order, the company chose to reduce its requested gross revenue deficiency to $20,736,000 on an annual basis. The Commission staff's attrition allowance results in an decrease to NOI of $6,189,000.

Intervenor POWER argues that an attrition allowance should not be granted in this case, while counsel for the public also takes the position that with the present economy the company should be required to forego this adjustment in order to recognize the financial plight of its customers.

When the company is experiencing vastly different rates of change in revenues, expenses and rate base, the problem of earnings attrition occurs. The Commission finds that a refusal to recognize this problem, as demonstrated by the record in this case, would amount to a refusal to allow the company a reasonable opportunity to earn its allowed rate of return.

The company and the Commission staff essentially use the same methodology in calculating their respective attrition allowance. A brief summary is sufficient.

Both the company and the Commission staff made an analys of past growth of revenues (excluding growth due in rate increases expenses and rate base that are likely to take place in the future which would affect the company's operation one year after the proposed rates become effective. Both assumed the proposed rates would be in effect on October 31, 1982.

The company and the Commission staff utilized the same revenues, expenses and rate base categories in their respective analyses.

Except as stated below, both used the same growth projection for expenses:

TABLE XI

Expenses	Growth Company %	Growth Staff %
Wage & Salary	15	10
Payroll Taxes	15	10
Real Property	0	2
O & M	15	9

The difference in growth projections for the above expenses is due to the fact that the Commission staff used more recent data than the company. Commission staff's projection of growth rates for the above expenses is accepted.

A. Growth Rate in Rate Base

Company and Commission staff used the same historical growth rate projections of production, transmission, distribution and general and intangible plant in service. The company's and Commission staff's projections for these rate base items are stated below:

TABLE XII

Item	Company Projected Rate Growth	Staff Projected Rate Growth
Production	1%	1.75%
Transmission	7	8
Distribution	10	7
General & Intangible Plant in Service	10	6.5

In the final analysis, the projected growth rate base difference for these accounts can be accounted for only because each witness determined their respective growth rates by their perception of what the growth rate will be during the attrition year. Consequently, the decision by the Commission must also in part rest on exercise of its judgment. The Commission accepts Mr. Louiselle's recommended growth rate for these rate base items because Mr. Louiselle has consistently, in his presentation, used more recent data.

U-82-12 PPL

VI. ATTRITION

Both the company and the staff in this proceeding submitted recommendations that the company receive an allowance for "attrition". Attrition is the term applied to circumstances where a utility's expenses grow faster than its revenues.

Many factors have been identified as contributors to attrition. These include inflation, technology, work force skills and abilities and the length of time required for regulatory decisions.

The company.and the Commission staff both presented recommendations that an allowance for attrition be granted to the company in this proceeding. The Commission staff recommendation, presented by Mr. Degernes, began with assumptions on revenue growth and power cost relating to Mr. Hess' presentation. Consistent with the Commission's decision relating to results of operations, it is believed that the company projections of special sales are more likely to reflect actual economic conditions and actual sales during the period of these rates. We accept the company's estimate of special sales, and the costs associated with that assumption.

As to the balance of the elements of the attrition projections, is believed that the Commission staff projections represent occurrences which are more likely to occur during the period when rates would be in effect than the projections of the company. Therefore, the balance of the Commission staff's presentation is accepted.

In determining an appropriate attrition allowance, the first step is to calculate results of operations after rate relief from the balance of the proceeding. Then, the revenues and costs are projected to the end of the attrition year, in this case December 31, 1983, by use of appropriate growth factors as specified above. Then the company's results of operations are calculated based on experience of the projected costs, and the attrition rate of return is subtracted from the authorized rate of return, as adjusted for weatherization allowances, producing a rate of return differential. The rate of return differential is multiplied by the attrition year rate base to produce the attrition net operating income required for the company to achieve its authorized rate of return. The net operating income

requirement is converted to gross revenue by use of a conversion factor and then is discounted to the test year to account for the time value of money. This result, shown in Table VIII, constitutes the attrition allowance which is authorized in this proceeding, $2,387,000.

TABLE VIII
PACIFIC POWER & LIGHT COMPANY
Attrition
($000 Omitted)

Rate of Return After Rates	13.02%
Attrition Year Rate of Return	12.61%
Difference - Attrition	.41%
Attrition Year Rate Base	$306,696
Attrition Year NOI Deficiency	1,257
Conversion Factor	.51332
Attrition Year Revenue Deficiency	2,449
Attrition Year Return Growth Rates	1.026
Attrition for Test Year Revenue Requirement	$ 2,387

U-82-38 PSPL

VII. ATTRITION ALLOWANCE

In measuring attrition both the respondent and the staff find that revenues are growing faster than expenses and taxes. The reason both give for an attrition allowance is that the rate base is growing faster than revenues, expenses and taxes.

The respondent's attrition study has the rate base increasing by 12.78% while the staff shows an increase of 11.72%. One of the differences between the respondent's and the staff's studies is the production adjustment discussed in the rate base section of this order. Since the Commission finds that this production adjustment should be reflected in an attrition allowance, the staff's study will be accepted. The staff's study must be adjusted for the restating actual and pro forma adjustment found to be proper in this rate case. With these adjustments the gross revenue requirement in this case for attrition is found to be $4,606,000.

U-83-26 WWP

VIII. ATTRITION

Attrition is the term applied to the circumstances where a utility's expenses grow faster than its revenues. Both the company and Commission staff proposed attrition adjustments for the period from December 31, 1983, through December 31, 1984. Counsel for the Public rejects the attrition adjustment as potentially duplicative of results of operations adjustments and as not providing the company with sufficient incentives for more efficient operation.

Attrition is caused by a variety of factors including growth in rate base, growth in expenses, and changes in demand. The company and Commission staff both begin their analyses with their respective 1982 results of operations after proposed adjustments. They then derive a revenue requirement using their authorized rate of return. The parties use growth factors to derive the 1984 projected results. These factors are calculated by the Commission staff and the company with the company using Box-Jenkins analysis and trended growth rates while the Commission staff relies on historical trends. Table X sets forth the growth rates of the company and Commission staff attrition studies.

TABLE X
THE WASHINGTON WATER POWER COMPANY
Attrition Growth Rate Comparison
Electric

Line No.	Attrition Categories	Company Growth Rate	Staff Growth Rate
	Operating Revenue:		
1	Base	5.32*	6.03*
2	Power Supply	Derived	Derived
	Expenses:		
3	Fuel	Derived	Derived
4	Purchase Power	Derived	Derived
5	Pension & Benefits	20.00	11.11
6	Wages & Salaries	8.00	(2.15)*
7	Depr. & Amort.	8.00	8.00
8	Payroll Taxes	13.00	(2.07)*
9	Gross Receipts	5.32*	6.03*
10	Other Taxes	4.00	0.00
11	Other O&M	8.00	8.00
	Rate Base:		
12	Production	.25	.25
13	Transmission	7.00	7.00
14	Distribution	7.00	7.00
15	General & Int.	9.00	9.00
16	Accum. Depreciation	8.00	8.25
17	Deferred Taxes	Derived	Derived
18	Weatherization	Derived	Derived
19	Water Heater Insulation Blankets	Derived	0.00

The Commission agrees with the Commission staff historical trend analysis for measuring attrition. In Table XI, the Commission has recalculated the attrition allowance using the authorized rate of return and the adjustments previously accepted in this case.

TABLE XI
THE WASHINGTON WATER POWER COMPANY
Attrition Revenue Requirement
(000's Omitted)

Line No.	Item	Amount
1	Rate Base	$449,994
2	Attrition Rate	0.17%
3	Additional Return to Bring Back to 12.52 (Note Includes Weatherization)	765
4	Increase in Weatherization Rate Base	$ 6,992
5	Additional Weatherization Return Rate	.008
6	Additional Weatherization Return	$ 56
7	Total Additional Attrition Return	$ 821
8	Conversion Factor	.517578
9	Revenue Deficiency	$ 1,586
10	Revenue Compound Growth Factor	1.0603
11	Test Year Revenue Requirement	$ 1,496

U-83-33 PPL

VI. ATTRITION

Both the company and the Commission staff in this proceeding submitted recommendations that the company receive an allowance for attrition. "Attrition" is the term applied to circumstances where a utility's expenses grow more quickly than its revenues.

The company filed a revised attrition study resulting in a finding that $2,350,000 is the total gross attrition revenue requirement, as adjusted for the increased return on weatherization investment. The company also submitted a separate elasticity adjustment sponsored by Mr. Pearson based on a demand elasticity study, to be used if the company's load forecast were not used for an attrition adjustment. The effect of the elasticity adjustment was to reduce the attrition revenue requirement to $1,030,000. The company's attrition study used as the attrition year the 12 months ended December 31, 1984.

On brief, the company abandoned its attrition analysis and elasticity adjustment in favor of the Commission staff's attrition analysis and adjustments, so long as the analysis and adjustments were recalculated according to resolution of the contested issues in this case. The company on brief did not contest the Commission staff's coal price adjustments and its exempt payroll adjustments only because those items were adequately treated in the attrition adjustment.

The Commission staff arrived at an attrition revenue requirement of $4,262,000, which does not reflect a premium for abandoned nuclear plant. The Commission staff found 73 basis points of attrition in calculating the additional revenue requirement recommended by the Commission staff to compensate the company for the expected level of attrition between the test year and the attrition year.

The Commission has reviewed the Commission staff's attrition analysis and accepts that analysis as proper after adjustment for decisions on contested matters previously discussed. The Commission's calculation of attrition revenue requirement, taking into account the decisions on contested matters in this case, is contained in Table X below. The attrition allowance authorized in this proceeding is $3,967,000.

U-84-28 WWP

9. <u>Adjustment 27 - Attrition</u>

Attrition is the term applied to the circumstances where the rate base of a utility grows faster than its net operating income after consideration of all appropriate pro forma and restating adjustments. The company proposes an attrition adjustment which increases the company's proposed revenue requirement by $4,705,000. In calculating this figure, the company used calendar year 1985 as the attrition year. For the 24-month period beginning with December 31, 1983, which is the end of the test period, and ending on December 31, 1985

12.44% to 11.93%. The company cites the Commission's acceptance in three previous rate proceedings of attrition allowances.

The Commission staff opposes an attrition adjustment. Although the Commission staff has in the past recommended attrition adjustments, the Commission staff in this matter asserts that information included in the record demonstrates that there is no need for an attrition adjustment. Because the Commission staff opposed an attrition adjustment, the Commission staff witnesses did not comment on the details of the company's attrition study, did not track how closely past attrition adjustments have mirrored actual events, or review adjustments in prior cases. The Commission staff concludes that the company's reported rates of return justify rejection of an attrition adjustment.

DPC supports the Commission staff's recommended rejection of the company's attrition request, based upon the company's actual results of operations. DPC notes that the Commission's prior orders stressed that an attrition allowance was an extraordinary measure to be used only when the absence of such an allowance would jeopardize the company's financial integrity and adversely affect the ability of the company to render required service to its customers at reasonable rates.

On rebuttal, the company contended that a limited review of the company's actual rates of return for the first half of 1984 was not a reasonable basis for the Commission staff's recommended rejection. The company further noted that the Commission staff had not undertaken a review of the company's methodology.

The Commission rejects the company's proposed attrition adjustment. The company has the burden of proof to demonstrate that this extraordinary measure is necessary. The company has not demonstrated that in the current climate of reduced inflation, a winding-down in the company's previously massive construction program, reduced debt financing, and projections for revenue growth, an attrition allowance is necessary. On the contrary, the evidence in the record demonstrates that the use of historical periods in attempting to project attrition would produce misleading results.

Although the Commission has rejected the company's attrition adjustment, the Commission is concerned that the Commission staff's opposition to the attrition adjustment was not based on an attrition analysis conducted by the staff. While the burden of proof does not rest with the Commission staff, the Commission would expect the Commission staff to perform its own analyses in the future in the process of arriving at its proposals.

U-84-65 PPL

VI. ATTRITION

In this proceeding, both the company and the staff presented expert testimony that the company required an "attrition allowance" adjustment to its results of operation in order to allow it the opportunity to earn its authorized rate of return over the period rates were expected to be in effect. The proposed order rejected both parties' recommendations, rejecting any attrition allowance in the proceeding. The Commission disagrees with the proposed conclusion that an attrition allowance is improper and disagrees with the standards applied in reaching that conclusion. It will authorize an attrition allowance in the amount of $1,161,000, calculated as recommended by the witness presented by the Commission staff, Mr. Louiselle.

In previous orders the Commission has recognized that in inflationary times, a utility may find that as it grows, its

expenses rise at a faster rate than its revenues.[1/] Regulatory delay or "lag", plus the additional time that rates may be in effect, may see a revenue shortfall because of the different growth rates. If the utility does not receive rates recognizing the different growth rates, a portion of its total expenses may be unrecoverable. Therefore, the Commission has recognized the validity of the expected expense and has permitted companies to recover it by means of an attrition adjustment or attrition allowance. The attrition allowance is designed to improve the likelihood that a utility has a true opportunity to earn its allowed rate of return.

The attrition allowance is not without its negative aspects. Its derivation requires a good deal of judgment. The same reasons that cause the Commission to use a historical test year rather than a forecasted test year would weigh against the use of an attrition allowance. The attrition allowance, however, tends to be smaller in scope than a forecasted test year, and thus more manageable. It is of a limited nature and is more susceptible of knowledgable evaluation.

Variation in the rate of inflation alone can have dramatic effects on the actual "attrition" experienced by a company, just as variation in investor earnings requirements or the cost of new debt issues can have dramatic effects on a company's ability to raise new capital or recover those legitimate costs out of earnings established in a proceeding such as this. To the extent that pro forma adjustments to historical data may be based in part on "estimates" of future costs, and to the extent that inflation is already factored into the cost of equity calculation under the DCF formula, there is a risk of double recovery. It is seen that great skill is required in the derivation of an attrition allowance.

[1/] Mr. Louiselle described attrition in the following manner (Exhibit T-56, page 2):

> . . . [U]nder actual operating conditions, a utility's future operations will be at a level different than the test year. Usually a utility's service requirements are growing; its investment, revenues and expenses can generally be expected to increase as service demand grows. As long as revenues and costs remain in balance, that is, remain in generally the same relative position as in the test year, future costs will still be covered. As new customers are incurred, revenue from these customers will also be received. Hence, total costs would still be covered, as long as the relative growth in revenues balances the growth in plant and expenses. Were this the case, the adjusted test year cost of service determination would provide the utility with the opportunity to earn its fair rate of return during the period when rates were in effect. . ..

The proposed order noted correctly that sound regulatory practice requires that the attrition allowance be used sparingly. The proposed order would authorize an attrition allowance, however, only when doing so is necessary to avoid setting rates so low as to be confiscatory under the Hope and Bluefield tests. The Commission believes that attrition is no more nor less subject to the Hope and Bluefield tests than any other expense of the company. That attrition may be the subject of a higher level of judgment does not render it different in kind, but only in degree, from the recognition of the past purchase of a pencil or an hour of labor at a stated cost. Other elements of the ratemaking process are similarly the subject of higher levels of judgment, including the calculation of investors' required rate of return, and the assignment of an appropriate hypothetical capital structure. With this theoretical basis in mind, the Commisison has reviewed the evidence offered in support of the proposed attrition allowances of both the company and Commission staff.

Through its attrition witness, Benjamin B. Sias, the company offers a study which combines econometric forecasts, budgeted costs, and detailed function-by-function analyses. On cross-examination Mr. Sias frequently deferred to those who produced the underlying data. Where particular expenses were declining historically, budgeted increases were factored into the projections for reasons which are unclear. The company presentation is not persuasive.

Mr. Louiselle presented the Commission staff analysis of attrition. Some elements of the presentation were drawn from the evidence of Mr. Towers: fuel costs, purchased power and jurisdictional allocations. Key areas of the attrition adjustment were revenues, wages and salaries, pensions and benefits, power supply, and attrition year jurisdictional cost allocations.

Mr. Louiselle's aggregated revenue forecast considers the most recent actual sales levels of the company. He projected an annual growth rate of 2.25 percent for the company's Washington operations. The figure is based upon the use of historical data and proper application of judgment. It will be accepted for purposes of the adjustment.

Mr. Towers' recommended adjustment to coal costs is appropriate under the circumstances expected to face the company, and properly establishes coal costs to be expected during the first year rates are to be in effect.

Mr. Louiselle estimated wages to rise at a 5 percent rate and employee growth at 1.8 percent, the figure used by the company is its own budget. He projected tax levels consistent with his other projections, and corrected for an omission in the company's presentation. The projections are a proper estimate of expense growth and should be allowed.

Mr. Louiselle recommended a 6 percent growth in pension and benefit expense, a level consistent with inflation estimates and the projected number of employes, and half the rate requested by the company.

Finally, the jurisdictional allocation of power supply costs was a significant element in the adjustment. All parties

agreed that the company had used an incorrect allocation factor in its attrition analysis. The Commission staff witness, Mr. Towers, adjusted the 1983 allocation note for known changes in the company's customer base, in a straightforward manner, from data provided by the company. It is easy to administer, and it is understandable. It is appropriate for use in the attrition analysis in this proceeding.[2]

In this case, the supporting witnesses include in their recommended attrition allowance a number of elements that would be properly included as individual pro forma adjustments and which might otherwise be unrecoverable. Their analysis is credible, and the Commission believes that the attrition allowance they recommend is reasonably required in order to compensate the company for its costs of operation during the time the rates in this proceeding are expected to be in effect. Although an "unusual" level of inflation is no longer anticipated, the Commission believes that the Commission staff-proposed attrition allowance has been shown necessary. The Commission staff-proposed methodology is well-reasoned, clearly presented on the record and based upon appropriate underlying data. It will be accepted, resulting in a gross revenue deficiency for this adjustment of $1,161,000.

[2] This adjustment uses a cost allocation based upon the company's present cost study methodology and is appropriate for purposes of this proceeding. The Commission has commented upon that methodology and made requirements for future presentations in Section IV.D. of this order, above.

VIII. ATTRITION

Attrition is a complex phenomenon which results from an unbalanced growth in revenues, expenses and/or rate base that causes a change in the rate of return from its authorized level. Commission staff witness Bruce M. Louiselle proposes that a negative attrition adjustment be adopted by the Commission for this proceeding. Beginning with actual test year results of operation, Mr. Louiselle estimates growth in revenues, expenses and rate base to reach a projection of the expected change in the rate of return during the time when rates from this case are in effect. According to Mr. Louiselle, complete analysis of attrition is especially important in this case as Puget has incorporated in its base case the two most significant causes of attrition, plant and expense growth, while failing to consider potential significant offsetting factors such as revenue growth. The witness analyzes changes in the company's first year rates caused by depreciation expense, property taxes, income taxes, revenue growth and net electric plant. Combined with these factors are revenue requirements and sales growth.

Mr. Louiselle challenges the company's assumption that its investment in the Washington Public Power Supply System nuclear plant No. 3 at Satsop, Washington should be included in the attrition year calculations. He argues that this assumption would be tantamount to Commission acceptance of the company's proposal to amortize WNP No. 3 investment in rates beginning January 1, 1987. Based upon the results of four analyses featuring varying treatment of tax and conservation variables, Mr. Louiselle concludes that a negative attrition adjustment should be reflected in Puget's revenue requirements.

On rebuttal, Mr. Story agreed to Mr. Louiselle's treatment of property taxes. However, three issues remain which differentiate the Commission staff's approach from the company method:

1. Calculation of income taxes for the attrition year;
2. Inclusion of WNP No. 3 in the attrition year rate base for the period from January 1, 1987 through March 31, 1987.
3. Use of different growth revenue forecasts for the attrition year.

Company witness Mr. Moreton offered an adjustment to the Commission staff income tax calculation by adding back the difference between attrition year and test year depreciation. Company witness Mr. Hoff offered an adjustment to lower the Commission staff growth factor from 7.3% to 6.93%. Company witness Charles Olson contends

that the failure by Commission staff to include WNP No. 3 in the attrition year understates attrition by $7.3 million.

In its brief, Commission staff pointed out that while the company projected revenue growth of 7.3%, its power cost estimates were predicated on an 8.11% growth in sales, which, upon further analysis, translates into a 7.5% growth in sales and a 7.3% growth in revenues which are virtually identical to those relied upon by Mr. Louiselle. Commission staff also challenges the company's calculation of tax deduction for depreciation. Finally, Commission staff urges that the ratemaking treatment for WNP-3 be considered in a separate proceeding and that no aspect of it be included in the attrition year.

Public Counsel opposes attrition adjustments in general but contends that in this case, the company has considered future changes in costs without giving comparable weight to changes in revenues. Public counsel particularly objects to the inclusion of WNP-3 costs in a portion of the attrition year.

The Commission accepts the Commission staff's proposed negative attrition adjustment. Review of the revenue growth projections indicates that Mr. Louiselle's figures more closely represent growth to be anticipated during the period when rates from this proceeding are in effect. The Commission finds that his computation of attrition year income taxes is appropriate and does not suffer from the error which the company contends. Finally, we do not agree that WNP-3 costs should be included in this proceeding under any guise. We anticipate that the WNP-3 costs and their appropriate disposition will be the subject of a separate proceeding. It is improper to suggest that they be included as a part of this attrition adjustment.

U-86-02 PPL

VII. ATTRITION

Attrition is the change in relationships between revenues, expenses and rate base that is expected to occur in the future time period after rates based on the historic pro forma test period are in effect. The company and the Commission staff performed attrition analyses using as the attrition year the 12 months ended June 30, 1987, in order to reflect the period during which rates will be in effect.

The company's attrition analysis was performed by Anne Eakin. She found a total gross attrition revenue requirement as adjusted for weatherization of $15,799,000. Company policy witnesses noted that the Commission has approved attrition allowances in the company's last three general rate cases. Company witness James Watson contended that the causes of attrition continue. Those causes are inflation, use of an historical test year, and cost increases that outpace sales growth during the period rates will be in effect. The company included in its attrition allowance the effects of Colstrip 4 and the Bridger Scrubber, which were not included originally in its base case.

The Commission staff presented two alternate recommendations. The Commission staff did not take a position favoring either of the alternatives. The first alternative was a study that calculated an attrition allowance of $3,804,000. The second alternative was the denial of any adjustment for attrition given recent and dramatic changes in economic variables. Commission staff witness Thomas Spinks analyzed the company's attrition calculation and made a number of adjustments to that calculation. Mr. Spinks noted that the DRI forecasts upon which the company's attrition analysis were based had changed substantially since the company ran the model. Despite those changes, the company did not rerun the model to reflect those changes.

Public counsel on brief contended that attrition allowances were no longer necessary or desirable under current economic conditions. Public counsel referred to the level of interest rates and inflation. Public counsel further contended that the company's failure to earn an allowed rate of return could be attributable to many factors other than those which would justify an attrition allowance. Public counsel also referred to the history of attrition allowances, including the necessity for attrition allowances in times of high inflation and large construction projects.

The Commission will accept the staff's calculation of the attrition allowance at $3,804,000. The Commission finds the staff case more persuasive regarding the level of attrition, taking into account recent changes in economic factors. The Commission notes the company's failure to rerun its model, in view of revised data from Data Resources, Inc. (DRI).

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V. ATTRITION

The company proposed an attrition adjustment which would increase its revenue requirement by $5.2 million. Attrition is the change in relationship among revenues, expenses, and rate base over time, in which growth in expenses exceeds growth in revenues from factors beyond the company's control. During periods when attrition threatened a company's fiscal health and its ability to provide service, the Commission has allowed an attrition adjustment to rate case revenue requirements.

WNG requested an attrition adjustment in this case. The Commission approved an attrition adjustment in the company's two previous rate cases. The company claimed that the economic conditions which warranted attrition adjustments in the past continue to be present today, particularly with regard to the company's rapid growth to serve new customers and new service territories.

Commission Staff opposed the attrition adjustment. The Staff argued that the economic factors which may have justified an attrition allowance in the past -- declining gas sales, increasing gas prices, and high inflation -- are no longer present. As to the actual attrition adjustment, the Staff took issue with the growth factors used by the company, and disagreed with the company's statement that it used the identical methodology in this case to develop an attrition allowance as was used by Commission Staff in the company's previous rate case.

The Commission concludes that no attrition adjustment should be granted in this case. An adjustment for attrition is an extraordinary measure, not generally included in general rate relief. A request for such an adjustment should be based on

extraordinary circumstances, not shown by the company to be present in this case.

Past attrition adjustments have been allowed when the Commission found that, without such an adjustment, the company would have no reasonable opportunity to earn its authorized rate of return. The Commission does not believe that the company will be impeded from earning its authorized return in today's climate of low inflation, declining interest rates, and increasing gas sales. The company already has an approved tracker mechanism to pass through changes in its cost of gas. This purchased gas adjustment further reduces the risk that attrition will have a negative impact on the company's ability to earn its rate of return.