BEFORE THE WASHINGTON

UTILITIES & TRANSPORTATION COMMISSION

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

---

DOCKET U-180907

SECOND COMMENTS OF PUBLIC COUNSEL

Prepared by:

Michael L. Brosch, Utilitech, Inc.

Corey J. Dahl, Regulatory Analyst

Lisa W. Gafken, Assistant Attorney General

Nina Suetake, Assistant Attorney General

April 30, 2019

BEFORE THE WASHINGTON
UTILITIES AND TRANSPORTATION COMMISSION

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	DOCKET U-180907

SECOND COMMENTS OF PUBLIC COUNSEL

April 30, 2019

I. BACKGROUND, INTRODUCTION, AND GENERAL COMMENTS

1. Public Counsel responds to the second Notice of Opportunity to File Written Comments (Notice), dated March 21, 2019. The Utilities and Transportation Commission (WUTC or Commission) issued the Notice to elicit input from stakeholders regarding expedited rate filings (ERFs). The Notice referenced Commission Staff's testimony in Puget Sound Energy's recent ERF conducted in Dockets UE-180899 and UG-180900, which noted the lack of a policy framework for ERFs and recommended the Commission develop further guidance for such a mechanism. The Commission concurred with Staff and determined this docket to be the appropriate forum to address the parameters for ERFs. The Notice identifies certain policy criteria, threshold criteria, methodology, and general considerations regarding ERF to be addressed in comments. These comments present Public Counsel's recommendations and include Appendix A, which includes brief summary answers to each of the specific questions raised in the Notice.

2. Public Counsel initially supported ERFs as a tool to provide an efficient and limited update to utility rates between rate cases, when needed, while maintaining important process

ATTORNEY GENERAL OF WASHINGTON
PUBLIC COUNSEL
800 5TH AVENUE, SUITE 2000
SEATTLE, WA 98104-3188
(206) 464-7744

protections. Since first proposed by Commission Staff in testimony during Puget Sound Energy's (PSE) 2011 general rate case,[1] PSE has filed two ERFs in 2013 and 2018,[2] and Pacific Power attempted to file an ERF in 2015.[3] Through experience with ERFs, we have learned that ERF regulation improperly compromises the effectiveness of regulatory oversight and stakeholder involvement, while engaging in selective, piecemeal ratemaking that invites utilities to choose the process that is most advantageous. Public Counsel believes the ERF approach poses several regulatory policy, due process, and ratepayer equity concerns. As a result, Public Counsel believes that the ERF approach is not appropriate and should be discontinued.

3. Public Counsel recognizes that there can be instances where a utility requires more immediate relief than can occur through general rate cases. While ERFs are fundamentally flawed, other mechanisms that maintain crucial customer process and protections are available to timely address the need for speed, when warranted. For example, the Commission could consider its interim rate relief policies in lieu of ERF regulation. Additionally, the Commission could develop policies regarding performance-based regulation (PBR), after engaging in a deliberate review of the current regulatory framework to determine what works, what needs improvement, and what solutions best serve the situation in Washington.[4] Public Counsel believes that the Commission has options other than ERF regulation that would better balance the public interest in situations where a utility is in financial distress.

---

[1] *WUTC v. Puget Sound Energy, Inc.*, Dockets UE-111048 & UG-111049 (*Consolidated*).

[2] *WUTC v. Puget Sound Energy*, Docket UE-130617; *WUTC v. Puget Sound Energy*, Dockets UE-180899 & UG-180900 (*Consolidated*).

[3] *WUTC v. Pac. Power & Light Co.*, Docket UE-152253, Order 03 ¶ 14 (Dec. 29, 2015). "The Company filed a tariff revision involving a rate change, and as stated above, RCW 80.04.130(1) provides the Commission with the full ten months to process the filing as an ERF or a general rate case. *ERFs are not a formal creation; such filings have no specialized regulations or statutes apart and separate from the Commission's general rate regulations.* The Commission does not recognize this filing as an ERF, but to the extent practicable, we have and will continue to expedite the procedural schedule." (Emphasis added).

[4] *See,* Initial Comments of Public Counsel ¶¶ 3-5, 13-23, 24-61.

4. As in our Initial Comments filed on January 17, 2019, Public Counsel will emphasize the critical distinctions between traditional cost of service regulation (COSR) and PBR. Notably, ERF regulation is the opposite of PBR, by intentionally accelerating the COSR processes; ERFs more rapidly translate increasing utility costs into higher rates borne by ratepayers.

5. In recent years, Washington's investor-owned utilities have consistently maintained investment grade credit ratings, while enjoying stable earnings and strong internal cash flows due to the Commission's responsiveness in GRC proceedings and the widespread use of decoupling, power cost tracking, and other supportive regulatory mechanisms. The Commission's regulatory approach is quite compensatory in relation to utility needs, despite being based on the historical test year.[5] For example, Washington's revenue-per-customer decoupling approach results in energy sales volumes reflecting "locked in" revenue growth in proportion to the number of customers being served, providing a built-in attrition relief mechanism. This built-in attrition relief allows the utility to retain revenue growth associated with customer growth while charging customers with the impact of usage per customer reductions, which is contrary to the essential ratemaking policy of matching.[6]

6. When a utility files back-to-back rate cases as we have experienced in Washington, the Commission should question whether the utility's management is efficient and insist upon rigorous analysis of costs. To do otherwise would reward high costs with higher rates, creating a strong disincentive to control costs. If, however, a utility can adequately demonstrate that regulatory lag or other factors are compromising its financial integrity or access to capital on reasonable terms, mechanisms such as emergency/interim rate relief, use of end-of-period rate base, and PBR options described herein, provide a more equitable solution than ERF.

---

[5] *WUTC v. Avista Corp.*, Dockets UE-160228 & UG-170229 (*Consolidated*), Order 06 ¶ 82 (Dec. 15, 2016).

[6] Michael L. Brosch, Exh. MLB-1T at 29:1 – 30:17, 34:4 – 35:9, *WUTC v. Puget Sound Energy*, Dockets UE-180899 & UG-180900 (*Consolidated*).

7. The Commission should continue to carefully evaluate, and then develop and apply more progressive PBR principles, including Multi-year Rate Plans (MRPs), which present a performance-oriented approach to regulation that reduces the frequency of rate cases, while expanding cost control incentives. In addition to MPRs, PBR regulation often also includes targeted performance incentives, to stimulate and reward the utilities' progress toward public policy goals defined by the Commission and/or legislature. Public Counsel continues to encourage the Commission to embrace changes to the existing regulatory framework only after (1) careful and deliberate consideration of advantages and disadvantages and (2) identifying specific problems arising from the current regulatory framework. Broadened use of ERF fails on both counts, as more fully described herein. Public Counsel concludes that ERFs provide advantages only to utilities by systematically enhancing utility earnings while diminishing regulatory oversight, eroding incentives for efficient management, and compromising the ability of stakeholders to effectively participate in the regulatory process.

II. ERF POLICY ISSUES

8. Regulatory "lag" is the inevitable passage of time from the preparation and filing of a utility rate case and the later the effective date of new rates. While regulatory lag serves an important and desirable policy goal of providing an incentive for cost control in an otherwise cost-plus ratemaking environment, the term "lag" tends to evoke a pejorative reaction. Notably, the Commission's Notice asks how ERFs might be used to "address," "remedy," or "resolve" regulatory lag.[7] Public Counsel respectfully submits that the essential foundational question is whether regulatory lag in Washington represents a significant problem for <u>all</u> of Washington utilities. Since the State's utilities are not experiencing declining financial integrity due to

[7] Notice at 2.

ATTORNEY GENERAL OF WASHINGTON
PUBLIC COUNSEL
800 5TH AVENUE, SUITE 2000
SEATTLE, WA 98104-3188
(206) 464-7744

regulatory lag, and they are able to receive needed rate relief when justified by record evidence, there is no reason to adopt a generic ERF solution to an unproven problem.

9. Alternatively, if certain of the state's utilities can demonstrate, at specific points in time, a financial urgency that justifies expedited rate relief, then that relief should be granted if the utility files sufficient evidence supporting emergency/interim relief in a pending GRC. Under that scenario, only the revenue increase amount tailored to meet the urgent financial need would be granted on an interim basis, and the interim rates would be subject to refund upon completion of the pending general rate case. Using interim rates, instead of ERF, properly balances a utility's need for financial stability with customers' need for fair rates and regulatory oversight.

10. The modest level of regulatory lag that occurs under Washington's GRC regulation yields important public policy benefits that include: (1) cost control incentives to utility management, (2) essential scrutiny of costs included in rates, (3) holistic, non-piecemeal revenue requirement determination, (4) procedural opportunities for effective stakeholder involvement, and (5) a fully developed record to support more balanced and accurate rate case decisions. Formalization of ERF for broadened use by Washington utilities would undermine all of these benefits.

A. Cost Control Incentives

11. Regulatory lag works symmetrically. Financial rewards occur when utility costs, net of revenue growth, decline between rate cases and penalties occur when costs increase. A profit-maximizing utility has an incentive to innovate and take the initiative to adopt new technologies, reduce the workforce where possible, and adopt best practices to reduce costs. The longer the period between rate cases, the greater the "regulatory lag" and the larger the incentive to reduce costs and therefore increase profits. Where management is successful in deploying new technologies or improved business processes that serve to increase productivity, the financial benefit of costs savings between rate cases accrue for the sole benefit of utility shareholders.

12. Alternatively, if utility management is less diligent in controlling costs, or other factors cause costs to rise more rapidly than customer revenues, utility shareholders absorb the financial burden of higher costs between rate cases until they are included in rates for cost recovery. The cost-control incentives arising from symmetrical regulatory lag represent important public policy benefits that are systematically eroded whenever ERF methods are used to more rapidly reward higher costs with higher utility rates.

13. Regulatory lag in a Washington GRC is not excessive, with a rate case typically completed within an 11-month procedural schedule.[8] While GRC test years in Washington start with test year historical costs and an average rate base computation, numerous pro forma and restating adjustments are routinely allowed in Washington rate cases. Ultimately, this allows utilities to include updated and more current cost information in rates. The rate case timeline in Washington is neither excessive nor unusual when compared to other state regulatory commissions. The Edison Electric Institute (EEI) publishes a quarterly "Rate Review Summary" depicting regulatory lag data. EEI notes that a 10-month average regulatory lag from the date of filing a rate case and receiving a ruling exists for the electric utility industry.[9] Public Counsel is not aware of any other state commission that has adopted expedited rate case processing in a manner comparable to ERF, even though many other state commissions employ historical test years within GRC proceedings.

---

[8] RCW 80.04.130(1); RCW 80.28.060(1); *See also*, Katherine J. Barnard, Exh. KJ-1T at 3, *WUTC v. Puget Sound Energy*, Dockets UE-180899 & UG-180900 (*Consolidated*).

[9] EDISON ELECTRIC INSTITUTE, RATE REVIEW SUMMARY, 4Q 2018 REGULATORY & FINANCIAL UPDATE, at 1 (2018), http://www.eei.org/resourcesandmedia/industrydataanalysis/industryfinancialanalysis/QtrlyFinancialUpdates/Documents/QFU_Rate_Case/2018_Q4_Rate_Review.pdf at 1; *See also*, EDISON ELECTRIC INSTITUTE, DELIVERING AMERICA'S ENERGY FUTURE, ELECTRIC POWER INDUSTRY OUTLOOK (2019), http://www.eei.org/issuesandpolicy/finance/wsb/Documents/EEI_WSB_Presentation.pdf at Slide 53. (Average regulatory lag in 4Q 2018 was slightly below the 10-month average in recent years.)

14. Currently, the financial "cost" of regulatory lag is benign. We enjoy an era of persistently low single-digit rates of annual inflation. Interest rates also remain at historically low levels, allowing cost-effective refinancing of maturing long-term utility debt while facilitating new capital investments at attractive cost rates. New information and automation technologies are available to utility management, providing tools to identify and execute on productivity improvement.

15. PBR approaches often employ MRPs that intentionally amplify regulatory lag so as to induce and reward utility cost control and efficiency improvement over the course of the rate plan. The National Regulatory Research Institute explained this issue succinctly in its 2016 Report on MRPs:

> The utility has an incentive to improve its cost efficiency once the regulator sets new rates until the next general rate case. Regulatory lag accounts for this incentive, which is more of a consequence of the impracticability of continuous rate reviews and changing economic conditions than by design. This incentive diminishes in a dynamic environment where utilities frequently file general rate cases. For example, if a utility achieves cost savings in 2016 and files a general rate case in 2017, those savings would normally start to flow back to customers when new rates go into effect. The reason lies with the mechanics of traditional ratemaking in setting the price, not the actual earnings of a utility. To the extent that utilities are able to hold down costs, their earnings and rate of return are higher. Customers do not receive the benefits, however, of lower utility costs until regulators include them in new rates after the next general rate case. [10]

16. The Commission approved a stipulated form of MRP for Puget Sound Energy in Dockets UE-121697 and UG-121705 for this stated purpose,[11] and the utility later testified that cost-control efficiencies resulted from its MRP.[12] A similar experience was reported for Avista's two-

[10] KEN COSTELLO, NATIONAL REGULATORY RESEARCH INSTITUTE, MULTIYEAR RATE PLANS AND THE PUBLIC INTEREST at 7 (2016), http://nrri.org/download/nrri-16-08-multiyear-rate-plans/.

[11] *In re Puget Sound Energy, Inc. and Northwest Energy Coal. For an Order Authorizing PSE To Implement Electric and Natural Gas Decoupling Mechanisms and To Record Accounting Entries Associated With the Mechanisms*, Dockets UE-121697 & UG-121705 (*Consolidated*), UE-130137 & UG-130138 (*Consolidated*), Order 07 ¶ 237 (June 25, 2013).

[12] *See, e.g*, Daniel A. Doyle, Exh. DAD-1T at 26-33, *WUTC v. Puget Sound Energy*, Dockets UE-170033 & UG-170034 (*Consolidated*).

year MRP, which began in 2012.[13] Furthermore, Pacific Power was granted a two-year rate plan beginning in May 2016 and has yet to file a subsequent GRC.[14] Assuming that adjustments during an MRP are set at appropriate levels that are fixed and not tied to changes in underlying costs, utility management is incented to reduce actual costs to improve earnings relative to the fixed MRP revenue levels. Adoption of ERF regulation, in contrast, represents movement in the opposite direction, providing expedited financial rewards for cost increases, while blunting the efficiency incentives provided by regulatory lag.

B. ERF Provides an Incomplete and Piecemeal Regulatory Response to Regulatory Lag

17. In a GRC, the utility must account for all changes in its costs and revenues associated with providing regulated utility service within a test year. The utility quantifies the amount of invested capital in rate base, develops a current cost of capital, and uniformly updates all revenue and expense elements of the income statement within a test year, so that an internally consistent view of the revenue requirement can serve as the basis for new rates. The detailed analysis of all inputs to the revenue requirement, including both favorable and unfavorable cost and revenue changes, is critically important to accurately determine a utility's revenue requirement.

18. WAC 480-07-510(3) provides the needed flexibility for analysis and interpretation of test year data within a GRC, requiring "[e]ach party that proposes restating or pro forma adjustments must include in its testimony and exhibits a detailed portrayal of the restating and pro forma adjustments the party used to support its proposal or position."[15] Examples of restating adjustments are listed therein, along with an invitation to include "Pro forma adjustments [that] give effect for the test period to all known and measurable changes that are not offset by other

[13] *WUTC v. Avista Corp.*, Dockets UE-120436 & UG-120437 (*Consolidated*), UE-110876 & UG-110877 (*Consolidated*), Order 09 & Order 14 (Dec. 26, 2012); Kelly O. Norwood, Exh. KON-1T at 8:9-12, *In re Avista Corp. Proposed Request for Proposals*, UE-140188 & UG-140189 (*Consolidated*).

[14] *WUTC v. Pac. Power & Light Co.*, Docket UE-152253, Order 12 (Sept. 1, 2016).

[15] WAC 480-07-510(3)(c).

factors."[16] Within a GRC, the recorded historical test year expenses, revenues, and all elements of the rate base are subjected to careful scrutiny, first by the utility in preparing its filing, then by Staff and other parties, and ultimately by the Commission. This careful scrutiny ensures that only reasonable, necessary plant investments and expenses are included and that revenues and costs are properly normalized or annualized for ratemaking purposes, in accordance with WAC 480-07-510.

19. Unique adjustments are often required in each new GRC that were not needed in prior rate cases due to new events or changed circumstances.[17] Thorough analysis of the underlying test year data and expert judgment of utility witnesses is therefore required to identify and quantify each of the utility's proposed GRC ratemaking adjustments. The utility must also develop and file supportive evidence for its capital structure and rate of return proposals, regulated revenues by source, actual rate base and results of operations, affiliate transactions, and cost studies that have been performed.[18] Then, through the discovery process and analysis of the Company's filing by Commission Staff, Public Counsel, and other stakeholders, different adjustments are proposed, based upon the informed judgment of the parties' expert witnesses. Through this process, the parties develop a complete record reflecting the alternative expert analysis of how to appropriately quantify the utility's revenue requirement. This record supports the Commission's deliberations and final rate order. The fact that significant ratemaking issues are routinely presented for Commission deliberation and decision-making in major rate cases

[16] WAC 480-07-510(3)(c)(ii).

[17] New adjustments are typically encountered, based upon new facts and changed circumstances, in each sequential GRC filing. For example, in Puget Sound Energy's 2017 GRC, new adjustments were proposed by the utility for environmental remediation, payment processing and the Company's South King Service Center according to PSE's response to Public Counsel Data Request No. 390. Staff, Public Counsel, and other parties typically propose their own new adjustments in GRC proceedings, raising issues that are either resolved in settlement or through Commission decisions in rate orders.

[18] WAC 480-07-510(3), (6).

clearly indicates that critical judgements are involved in revenue requirement and rate design development, with new and different issues raised from one GRC to the next.

20. In contrast, an ERF proceeding intentionally shortcuts these procedures and filings, by substituting information from Commission Basis Reports (CBRs) as the basis for rate changes, with minimal critical analysis or further adjustment and with little opportunity for discovery and input from stakeholders.[19] CBRs are prepared and annually filed for the primary and limited purpose of monitoring utility financial results.

21. CBRs reflect only the required and somewhat mechanical application of "all the necessary adjustments as accepted by the commission in the utility's most recent general rate case or subsequent orders."[20] The assumption is that the ratemaking adjustments used in the past rate case will provide a sufficiently accurate view of the utility's financial information to understand generally how the utility is performing.[21] CBRs do not require detailed analysis of recorded transactions and potentially unique events that transpired during the new financial reporting period, nor do they contain any new adjustments that may be required if more detailed analysis were undertaken. Additionally, CBR results do not provide updated capital cost, affiliate transactions, and cost of service studies that are required for filing a rate case under WAC 480-07-510.

22. ERF proceedings provide very limited opportunity for effective stakeholder involvement. For example, a non-unanimous settlement agreement in Puget Sound Energy's previous general

[19] Stakeholders endeavor to review ERF filings as diligently and as comprehensively as possible under the time constraints. However, parties had approximately 19 days to conduct discovery in Dockets UE-130137 and UG-130138. In Dockets UE-180899 and UG-180900, parties had approximately 3 months for discovery, testimony development, and negotiations due to the intervening winter holidays that occurred immediately after the ERF was filed.

[20] WAC 480-100-257.

[21] Even the application of prescribed adjustments from a previous rate case within CBR reports can involve judgment around what new transactions require restatement or normalization and around methods used to interpret data and determine appropriately more "normal" levels of costs.

rate case included a commitment from the settling parties to support, or not oppose, a 120-day adjudication schedule for an expedited rate filing, which PSE filed in Dockets UE-180899 and UG-180900 (*Consolidated*).[22] Processing a utility's request to increase electric customer rates by $18.9 million and natural gas customer rates by $21.7 million[23] using ERF procedures, within less than one-third of the time available in the normal eleven-month GRC rate case procedural schedule, results in massive truncation of the time to conduct essential discovery and issue development. This severely disadvantages Staff, Public Counsel, and other parties who need to mobilize resources and diminishes their ability to effectively participate in rate cases.

23. Aside from schedule compression, the intent behind ERF filing procedures is to narrow the scope of regulatory analysis by replicating ratemaking adjustments that were needed in previous rate cases, while ignoring any changes in the cost of equity capital, cost of service allocations, and any new or modified affiliate interest problems. While the idea of a limited update of utility expenses seems intuitively reasonable, ERF processes result in inappropriate piecemeal ratemaking, where some but not all revenue requirement determinants are considered and updated. As a result, this narrowing of regulatory oversight likely does more harm than good and provides no opportunity for identification and development of new issues present within the updated test year.

24. For example, the Commission acknowledged in its Order 05 approving settlement of PSE's recent ERF "the inherent difficulty of conducting a prudence review in the short timeframe afforded in this expedited filing and agree that deferring prudence reviews until the Company's next general rate case is a reasonable solution that will allow all parties and the

[22] Through global settlement of issues in these proceedings, Order 05 approved the Settlement Agreement on February 21, 2019, only 106 days after Puget Sound Energy filed it tariffs seeking ERF revenue increases pursuant to the previous rate case non-unanimous settlement and well within the proposed 120-day schedule.

[23] Barnard, Exh. KJB-1T at 23:5-8, *WUTC v. Puget Sound Energy*, Dockets UE-180899 & UG-180900 (*Consolidated*).

Commission to conduct a more thorough analysis."[24] Of course, until then, utility customers are burdened with costs for plant investments embedded in ERF rates until any needed prudence adjustments are proposed and applied in future rate cases.[25] Additionally, rate design concerns, if any, are also delayed under ERF regulation, in which no updating of cost of service allocations or rate design occurs, even though changes in the utility's overall cost of service or relative class demand levels may support rate design outcomes.

25. If ERF regulation is more broadly practiced in Washington, ratepayers will likely bear the consequences of utilities choosing the most advantageous ratemaking process to suit corporate goals. Utilities will be able to choose the form of regulation that maximizes revenues and shareholder income, while simultaneously limiting full review and stakeholder involvement when advantageous. Whenever recorded utility costs have increased in a particular year within the CBR reports, an ERF filing can be used to quickly bake such higher costs into increased rates with minimal delay and reduced regulatory oversight. On the other hand, if new pro-forma adjustments, an updated cost of capital and/or updated cost of service evidence provides a better financial opportunity for shareholders, the utility can be expected to file a GRC and is under no obligation to consistently follow the ERF approach. Because utilities always possess an information advantage over rate case participants, ratepayers are at great risk of being disadvantaged when utilities have the ability to choose between rate case options. Utilities will utilize their information advantage[26] to guide decisions about which approach – ERF versus GRC – will provide higher revenues at any specific time.

---

[24] *WUTC v. Puget Sound Energy*, Dockets UE-180899 & UG-180900 (*Consolidated*), Order 05 at 9:26 (Feb. 21, 2019).

[25] The settlement approved by the Commission specifically did not identify capital investments that were included in rates, and refunds are not provided for in the event that any of the projects since the utility's last rate case test year are found to be imprudent. Certainly, any imprudent costs that are passed along to customers through the ERF would be corrected through rates at the conclusion of the subsequent GRC. This, however, poses concerns about intergenerational inequities.

[26] Utilities possess the ability to determine if, when, and what they file. This leaves all stakeholders, including Staff, with a potentially compressed time period to develop positions and respond.

26. As the Commission recognizes, ERF processes and procedures have been vaguely defined to date, which leaves ERFs prone to abuse. In the Commission's Notice, it elicits comments on fundamental questions regarding ERF threshold criteria, standards to demonstrate need for ERF, conceptual framework for an ERF, and a series of important technical details not presently defined or documented within statute, administrative rules, or Commission precedent. The unfortunate reality is that no expedited path toward fair, just, reasonable, and sufficient utility rates has been found in Washington, or by other state commissions, that does not compromise the public interest concerns described herein.

27. These fundamental uncertainties were highlighted in the recent PSE proceeding where the utility's witness stated, "This ERF is generally consistent with the approach outlined in the 2017 Settlement Agreement, except where the Company has made modifications to address concerns identified by Commission Staff, which are discussed in more detail later in my testimony."[27]

28. Mr. Chris McGuire, Staff's witness in the same PSE docket, raised many policy and conceptual concerns about ERF ratemaking, indicating his concerns were "not by any means a comprehensive list of questions but, rather, a sample that I hope will help to demonstrate the need for policy guidance on this issue."[28]

29. Public Counsel does not believe that the foundational, procedural, and implementation problems surrounding ERF can be solved. The Commission has allowed experimental ERFs to explore whether they serve the public interest and result in fair, just, reasonable, and sufficient rates. The Commission should now suspend use of ERF, favoring instead more equitable mechanisms when utilities raise concerns about unduly burdensome lag. Particularly,

---

[27] Barnard, Exh. KJB-1T at 5, *WUTC v. Puget Sound Energy*, Dockets UE-180899 & UG-180900 (*Consolidated*). Ms. Barnard then discusses departures from ERF to incorporate end of period rate base adjustments, annualization of depreciation and revisions in the scope of excluded production costs. *Id.* at 6-10.

[28] Chris R. McGuire, Exh. CRM-1T at 20, *WUTC v. Puget Sound Energy*, Dockets UE-180899 & UG-180900 (*Consolidated*).

emergency/interim rate relief subject to refund provides an alternative to ERF that is responsive to specific, demonstrated utility financial emergencies and would provide expedited rate relief only when truly needed, all within pending GRC proceedings where stakeholder participation and regulatory oversight would not be disadvantaged.[29]

C. ERF - Responsiveness to Change

30. The Commission's Notice questions whether companies, ratepayers, and the Commission are responding fast enough to the changing energy landscape and, if not, how ERFs can be used to improve responsiveness.[30] Public Counsel respectfully submits that the changing energy landscape poses larger questions than ERF regulation can answer. The changing energy landscape also requires strong regulatory oversight to ensure that change is implemented in equitable, efficient, and meaningful ways. Indeed, the solution to utility and regulatory responsiveness concerns is <u>not</u> to burden ratepayers with higher utility rates resulting from expedited traditional COSR, coupled with less comprehensive rate case oversight. Having hope and trust that utilities will prudently reinvest their improved earnings and cash flow created by ERFs will not necessarily improve responsiveness to desirable policy directions.

31. Rather, more careful and deliberate commission and stakeholder involvement in utility planning dockets, including utility system expansion and grid modernization proceedings and subsequent GRC proceedings where plans are implemented, would represent a much more proactive role for all parties to ensure utilities respond to change. Public Counsel urges the Commission to first consider whether traditional regulatory approaches are failing to achieve the priority goals we described in our January 17 comments,[31] and then investigate whether more performance-based regulatory approaches should be pursued.

---

[29] These comments also discuss use of end-of-period rate base and exploration of PBR as additional alternatives available to the Commission.

[30] Notice at 2.

[31] Initial Comments of Public Counsel ¶¶ 19-23.

32. To date, there has been no showing that Washington utilities are financially unable to raise capital that may be needed to respond to industry change. Furthermore, there been no showing that our utilities are unable or unwilling to be responsive to change by investing in new technologies or enabling grid upgrades.

33. Indeed, the State's utilities are actively supporting electric vehicle pilot programs, advanced metering infrastructure, and grid modernization. Broader use of ERFs may cause undesirable outcomes, by eliminating GRC proceedings that now provide a forum to evaluate the costs and expected benefits of specific utility proposals to address the changing energy landscape. These proposals have potential to provide vast benefits, but those benefits must not be illusory and must be verified and adequately quantified. Additionally, these proposals are often very expensive, and it is critical to closely review the business cases behind the proposals. The details of utility proposals to address industry transitional issues matter greatly to Washington ratepayers. Widespread ERF acceleration of rate cases may unreasonably truncate stakeholder and public scrutiny of such details.

34. ERF serves only to expedite rate relief, by limiting the scope of regulatory review and shortening the procedural schedule that would otherwise govern general rate changes under COSR. As a result, ERFs serve to indiscriminately improve the return on all new utility investments, relative to standard GRC regulation. Unfortunately, any new investment "stimulated" by ERFs in this way may burden ratepayers with higher costs without regard to whether specific investments are prudent, the least-cost solution among resource options, or even supportive of transformational goals rather than business as usual.

35. A frequent criticism of traditional COSR regulation is the structural incentive to over-invest in plant assets. Realistically, the only way for a utility to significantly grow the business and its earnings is to increase investment in plant that is included in rate base. COSR systematically rewards higher utility costs with higher revenues through the ratemaking process.

The resulting bias encourages utilities to increase its rate base, which may reduce incentives to develop resources that may yield higher societal benefits, such as displacing utility-owned fossil fuel generation. Investments in distributed energy resources, demand response, and third-party development of utility-scale renewable resources may not be encouraged.

36. Responsiveness to industry change may not be best served by traditional COSR, which is the broader question discussed in Public Counsel's January 17 Comments in this docket.[32] ERF has the effect of amplifying all of the most negative attributes of COSR, by reducing regulatory lag incentives for utility cost control and increasing the bias toward potential utility over-investment, when other resource options may be more cost effective or desirable. At the same time, ERF does not offer any public policy benefits to Washington regulation by merely accelerating the translation of higher costs into higher rates, all while reducing the Commission's important oversight of utility investments and overall spending that occurs in GRCs. As the Commission and other stakeholders move toward enforcing legislation aimed at ramping up renewable energy development, thorough review of utility spending on major capital investments becomes even more critical.

III. THRESHOLD CRITERIA FOR ERF

37. As noted in its previously filed comments, Public Counsel believes that changes to the regulatory framework should only occur when clearly defined regulatory goals are not being satisfied using existing regulatory mechanisms, and where the benefits of modified regulatory mechanisms clearly outweigh the risks and costs of making the change. From Public Counsel's viewpoint, ERFs do not solve any clearly defined and unmet regulatory goals. Therefore, Public Counsel submits that the Commission should reject use of ERF and that no criteria should be

[32] Notice of Workshop (Nov. 9, 2018).

developed for broadened use of ERF regulation, given the many problems noted previously by Commission Staff[33] and in these comments.

38. In the alternative, exceptional relief on an expedited and interim basis should be considered and granted only in response to demonstrated financial emergency conditions proven by a utility within a pending GRC. Such emergency interim relief would be timely and responsive to proven financial needs without compromising the procedural steps and scheduling intervals needed to facilitate comprehensive review by all stakeholders. Under these conditions, rate changes remain consistent with the public interest because they are supported by sufficient evidence.

39. A full rate case is ultimately needed to determine whether a utility's current rates are fair, just, reasonable, and sufficient. In this process, rates are set considering all of the inputs to revenue requirement determination, including prudent plant additions and other rate base changes, operating expenses and taxes, an updated cost of capital, and cost of service/rate design matters. Adequate time and a reasonable opportunity for intervention, discovery, financial analysis, issue development, testimony, and hearings must be provided in the interest of due process to consider all issues. ERFs should not be employed to avoid or delay formal rate case review.

40. Utilities may assert that the risk or expectation of future earnings attrition justifies relaxing formal regulatory review and granting expedited rate relief using ERF procedures. Earnings attrition arises from persistent growth in the utility's costs to provide service that exceed growth in customer and sales revenue levels between test years. This was a persistent concern years ago, when inflation and interest rates were elevated or when, more recently, recessionary conditions negatively impacted customer load and revenue growth. However, in this

[33] Chris R. McGuire, Exh. CRM-1T at 20, *WUTC v. Puget Sound Energy*, Dockets UE-180899 & UG-180900 (*Consolidated*).

current era of modest inflationary pressure upon costs, technological advancements to improve productivity, and low interest rates, any Washington utility alleging a serious earnings attrition problem merits increased regulatory scrutiny by the Commission, Staff, and other stakeholders, not expedited rate relief

41. Similarly, the Commission should not accept the ERF ratemaking shortcuts that may appear attractive as an administrative remedy for increased workloads resulting from frequent GRC proceedings. The public interest demands comprehensive regulatory review of all proposed significant rate changes, on a holistic and balanced manner, without compromising the scheduling process and stakeholder participation that provide safeguards normally afforded in GRC proceedings. In considering PBR within these dockets, the Commission will have the opportunity to determine whether PBR mechanisms should be used in Washington. MRPs could be developed, which would reduce rate case frequency, and when appropriately designed, they may encourage efficiencies and improved utility performance. While MRPs can reduce rate case frequency, they provide regulatory oversight under conditions that allow adequate review and stakeholder engagement, if designed properly. Additionally, well-designed MRPs reward management efficiency by expanding regulatory lag and de-linking utility costs from revenues during the term of the MRP.

IV. ERF METHODOLOGY RECOMMENDATIONS

42. Public Counsel's experience is that ERFs have proven to be a flawed ratemaking and regulatory methodology. As a result, Public Counsel does not support adoption of a formalized ERF as a tool to grant permanent rate relief on an expedited basis. As discussed elsewhere in these comments, Public Counsel believes that one better alternative would be use an interim rate process within general rate cases to address emergency financial conditions of a utility.

43. ERF regulation compromises several important rate case principles, a number of which are previously discussed in these comments. This process hinders the following important components of a full rate case process:

- The "matching" principle is compromised when all elements of the ratemaking process are not comprehensively updated.
- When ERFs are completed soon after they are filed, the time needed for stakeholders to evaluate potential issues, solicit and contract for expert services, conduct multiple rounds of discovery, develop issue positions, and present credible testimony is compromised.
- The prescription of only standardized adjustments within ERF, as previously approved by the Commission and filed in CBR financial statements, compromises the essential need for analysis of updated test year data to identify any new adjustments that are needed.
- Because Plant in Service balances are updated, new plant is included by default in ERF rates. ERF regulation precludes any meaningful prudence investigation around new investments before such investments are included in customer rates for cost recovery.
- The schedule compression experienced under ERF limits parties' ability to fully assess the limited record in order to meaningfully brief the issues presented.

V. GENERAL CONSIDERATIONS

44. The questions posed in the Commission's Notice pertaining to general considerations have been addressed in other sections of these Comments. As a general matter, ERFs expedite cost recovery for the benefit of utility shareholders, but at the cost of decreased ability for Staff, Public Counsel, and other stakeholders to adequately review and respond to the filing. As a

result, the record presented to the Commission is significantly less robust than in a GRC. A GRC, with an interim rate component if necessary, would provide the Commission with an adequate record to establish fair, just, reasonable, and sufficient rates that are in the public interest and appropriately balances the interests of shareholders and ratepayers.

VI. OTHER MECHANISMS PROVIDE BETTER ALTERNATIVES TO ERF WHILE BEING RESPONSIVE TO A UTILITY'S DEMONSTRATED NEED FOR EXPEDITED RATE RELIEF.

45. The Commission has adopted structural changes to Washington's regulatory framework when needed in the past, to respond to identified problems in a manner that largely balances public interest concerns with utility industry needs. Examples include revenue decoupling, power cost and purchased gas cost tracking and recovery mechanisms, accounting deferral, and recovery for extraordinary storm restoration costs. ERF was proposed during a time when many Washington utilities were complaining of earnings attrition, and ERF was theoretically a way to update rates within a short period after setting general rates. ERF has not proven to balance public interest concerns with industry needs and should be rejected in favor of the alternatives described below.

A. The interim rate process provides timely relief when needed.

46. The Commission has granted interim rates to address a utility's need for more immediate rate relief. For example, the Commission recognized that Olympic Pipeline presented a situation that required a different approach than simply proceeding with that company's rate case without addressing interim rates.[34] In doing so, the Commission recognized that the primary question it must answer is whether granting interim rates would be in the public interest. The Commission

[34] *WUTC v. Olympic Pipeline Co.*, Docket TO-011472, Third Supplemental Order, Order Granting Interim Relief In Part ¶¶ 37-47 (Jan. 31, 2002).

described interim relief as "a mechanism to provide limited support to a public service company facing an immediate need and whose other immediate options are not viable."[35]

47. When evaluating a request for interim rates, the Commission considers the following factors, first developed in 1972:[36]

1. The Commission should exercise its authority to grant interim rate relief only after opportunity for an adequate hearing.
2. Interim relief should be granted only where an actual emergency exists or where necessary to prevent gross hardship or gross inequity, recognizing that an interim rate increase is an extraordinary remedy.
3. "The mere failure of the currently realized rate of return to equal that approved as adequate is not sufficient, standing alone, to justify granting interim relief."
4. The Commission will review whether the grant or failure to grant interim relief will have an effect on the company's financing demands as to substantially affect the public interest. In doing this, the Commission will consider rate of return, interest coverage, earnings coverage, and the immediate and short-term demands for new financing.
5. Interim relief is a tool to stave off disaster, but should not be granted simply because disaster has struck or is imminent. It must be applied only in cases where failure to grant would cause clear jeopardy to the utility and detriment to its ratepayers and stockholders. Interim relief should not be granted when a full hearing can be held and the general rate case resolved without clear detriment to the utility.

[35] *Id.* ¶ 37.

[36] *Id.* ¶¶ 38-39 (citing *WUTC v. Pacific Northwest Bell Telephone Co.*, Cause No. U-72-30, Second Supplemental Order (Oct. 1972)).

6. The Commission is guided in its decision to grant or not grant interim relief by the mandate to "regulate in the public interest" found in RCW 80.01.040. Regulating in the public interest is the Commission's "ultimate responsibility."[37]

48. Public Counsel believes that the six factors above provide a strong foundation for addressing situations where a utility requires expedited rate relief. Under emergency conditions, an interim revenue increase could be considered and quantified based upon a utility's urgent problem, early in the processing of a pending full rate case. The utility requesting such treatment would file additional evidence documenting the facts surrounding the alleged emergency creating need for interim relief, as well as quantification of needed interim revenues to help resolve the emergency.

49. Interim relief would require more than a showing that the utility is earning less than its authorized return. A utility requesting an emergency, interim rate increase could provide documentation of an imminent decline in its credit rating, reduced access to capital on reasonable terms, or potentially significant impairment of its operations that can only be avoided through expedited rate relief. Both Puget Sound Energy and Avista sought interim rate relief in 2001 outside the context of GRCs.[38] The Commission, using the six factors described above, granted Avista's request and rejected PSE's request. The Commission's determination rested on whether the utility presented adequate evidence of financial distress.[39] In ordering interim rates for Avista, the Commission granted "the minimum we believe to be immediately necessary for the

---

[37] *WUTC v. Olympic Pipeline Co.*, Docket TO-011472, Third Supplemental Order, Order Granting Interim Relief In Part ¶¶ 40-46 (Jan. 31, 2002).

[38] *WUTC v. Puget Sound Energy, Inc.*, Docket UE-011163 & UE-011170, Sixth Supplemental Order (Oct. 4 2001); *WUTC v. Avista Corp.*, Docket UE-010395, Sixth Supplemental Order (Sept. 24, 2001). Puget Sound Energy planned to file a general rate case by November 2001. *WUTC v. Puget Sound Energy, Inc.*, Docket UE-011163 & UE-011170, Sixth Supplemental Order ¶ 28 (Oct. 4 2001). The Commission ordered Avista to file a general rate case by December 2001. *WUTC v. Avista Corp.*, Docket UE-010395, Sixth Supplemental Order ¶ 112 (Sept. 24, 2001).

[39] *WUTC v. Puget Sound Energy, Inc.*, Docket UE-011163 & UE-011170, Sixth Supplemental Order (Oct. 4 2001); *WUTC v. Avista Corp.*, Docket UE-010395, Sixth Supplemental Order (Sept. 24, 2001).

Company to preserve its ability to fulfill its service obligations to the public."[40] Simplified surcharge percentages could be used to recover from all customer classes any emergency, interim revenue increases approved by the Commission under the approach described herein. Then, in the final rate order, interim surcharges would be eliminated in favor of permanent rate changes required in compliance with the Commission's final rate order.

50. In the event that rates authorized in the final order are less than the interim rates granted, or in the event that the Commission determines that interim rates were excessive, such rates would be subject to refund. Indeed, this occurred with Olympic Pipeline, which was awarded a 24% interim increase, but received a rate increase of only 2.52% in the final order. The Commission ordered refunds of the interim increase in the proportion that customers paid in excess of the final order.[41]

51. Interim rate relief is a targeted response to a proven problem, based upon utility-specific record evidence of actual need, and without compromising important consumer protections present within GRC proceedings in Washington. In contrast, formalizing ERF regulation would compromise all of the ratemaking principles described herein, encouraging utilities to file ERF applications early and often, in order to address alleged earnings attrition concerns while systematically improving financial results all at ratepayers' expense.

B. Use of end-of-period rate base can alleviate excessive regulatory lag.

52. If, after deliberate consideration, the Commission finds that strategies to reduce regulatory lag is needed, more expansive use of end-of period rate base valuation, with corresponding annualization of customer sales revenues, operating expenses, and depreciation as of test year-end, should be considered as a meaningful and responsive policy change. Use of year-end rate base with annualized income statement adjustments would not compromise the

[40] *WUTC v. Avista Corp.*, Docket UE-010395, Sixth Supplemental Order ¶ 8 (Sept. 24, 2001).
[41] *WUTC v. Olympic Pipeline Co.*, Docket TO-011472, Twentieth Supplemental Order (Sept. 27, 2002).

essential test year matching and comprehensive regulatory review process that is needed, but would reduce regulatory lag by six months in every rate case undertaken with this approach

C. PBR offers alternatives to ERF.

53. As noted in comments herein, the Commission may find that PBR approaches, employing MRPs and targeted Performance Incentive Measures, merit more detailed analysis and development efforts in this docket. PBR represents an alternative to ERF that emphasizes management performance, rather than sequentially higher utility costs and prices. PBR may provide strengthened incentives to encourage utility support and achievement of Washington's public policy goals, all while preserving affordable utility rates and sound regulatory principles.

VII. CONCLUSION

54. While ERFs would further reduce regulatory lag, they also amplify the concerns associated with traditional COSR, where higher costs are quickly rewarded with higher revenues. More rapid rate increases through ERFs represents movement in the wrong direction. Such movement is inconsistent with the affordability and cost control goals consistently advocated by Public Counsel. Washington's investor-owned utilities are generally healthy companies according to Commission Basis Report filings over the last several years, indicating that COSR approaches do not need to be expedited.[42]

55. Public Counsel recommends that the Commission reject ERF as a regulatory tool, opting in favor of using interim rate processes to address a utility's need for immediate rate relief under appropriate circumstances. Importantly, ERF is not a remedy to address the challenges posed by ongoing changes in the energy sector, which are the primary concern in this Investigation. In

[42] According to CBR Report calendar year results, Avista, Pacific Power and PSE experienced earned rate of return in excess of Commission-authorized levels in both 2016 and 2017. The electric utilities in Washington have consistently earned rates of return near or exceeding authorized levels in all years 2013 through 2017, indicating the adequacy of the existing regulatory framework in meeting the financial needs of electric utility shareholders.

order to address these challenges, the Commission should continue to address the adequacy of the current regulatory framework and explore PBR alternatives if a need is demonstrated.

56. Dated this 30th day of April 2019.

ROBERT W. FERGUSON
Attorney General

/s/ Lisa W. Gafken

LISA W. GAFKEN, WSBA No. 31549
Assistant Attorney General
Public Counsel Unit Chief
NINA SUETAKE, WSBA No. 53374
Assistant Attorney General
COREY J. DAHL
Regulatory Analyst

PUBLIC COUNSEL EXPEDITED RATE FILING - SUMMARY OF COMMENTS

	Policy Issues	**Public Counsel Recommendations:**
1	**Regulatory Lag**	Regulatory Lag is not excessive in Washington, given rate case completion consistent with averages in other states, acceptance of pro-forma adjustments included in GRCs, decoupling on a "per customer" basis and the multiple cost trackers available to utilities. No broadened ERF remedy is needed.
a	ERF an important tool?	No. ERF is poor public policy that compromises effective regulation dilutes financial incentives for utility cost control and results in inaccurate and piecemeal ratemaking.
b	ERF an effective remedy?	No. Emergency interim rates, subject to refund, serve as a more effective and targeted remedy for any severe and proven regulatory lag problems experienced by specific Washington utilities.
c	Other non-ERF solutions?	Multi-year rate plans as part of Performance Based Regulation could more effectively promote utility efficiency and transformational public policy goals, rather than simply expediting cost-plus COSR regulation. End of period rate base could also be employed to reduce regulatory lag by six months within GRCs.
d	Tie ERF to rate case moratorium?	A multi-year rate plan in the context of PBR could reduce GRC frequency and provide attrition relief in fixed amounts not tied to utility expense levels, to improve utility incentives for cost control while also reducing the regulatory burden of serial rate cases.
2	**Responsiveness to Change**	
a	Is response to Change adequate - will ERF help responsiveness?	No. ERF ratemaking burdens ratepayers with higher costs sooner, improving utility earnings, while doing nothing to improve responsiveness to change. GRC proceedings are useful venues for regulatory oversight of utility responsiveness to needed changes.
3	**Other Policy Issues**	
a	Other Policy Issues ERF can address?	ERF is poor public policy and a flawed methodology that should be rejected.
b	How do ERFs impact policy issues?	ERF is the opposite of Performance Based Regulation, rewarding higher utility costs with new revenues, rather than encouraging and rewarding performance toward targeted policy issues.
c	Other non-ERF solutions to policy issues?	Careful consideration of PBR is encouraged by Public Counsel, rather than adopting expedited COSR that does nothing to advance utility responsiveness to legislative and regulatory policy directives.
Threshold Criteria		
1	Under what circumstances is ERF appropriate?	Emergency interim rates, subject to refund, represent a more effective remedy than ERF for proven, severe regulatory lag.
2	What standard to demonstrate need for ERF?	Use existing standards to employ interim rates in response to demonstrated financial need, rather than indiscriminately adopting ERF policies.
3	Is fair, just and reasonable standard different for ERF than in general rate	Fair, just and reasonable standards are improperly compromised under ERF.
Methodology		
1	Appropriate conceptual framework for ERF?	Careful consideration of PBR is encouraged by Public Counsel, rather than expedited COSR.
2	ERF use of new versus recent test year updated for capital additions?	There are no acceptable ERF methods to remedy the many problems caused by expedited COSR. The inherent subjectivity and piecemeal nature of ERF regulation is revealed by this question.
3	ERF to include all new Plant, only major investments, or only non-revenue producing plant?	There are no acceptable ERF methods to remedy the many problems caused by expedited COSR. The inherent subjectivity and piecemeal nature of ERF regulation is revealed by this question.
4	ERF plant inclusion without prudence review or ERF rates subject to refund pending prudence review?	There are no acceptable ERF methods to remedy the many problems caused by expedited COSR. ERF regulation is not compatible with the need for prudence review of costs before they are translated into higher rates.

5	Should expenses be updated in an ERF or tied to prior rate case?	There are no acceptable ERF methods to remedy the many problems caused by expedited COSR. The inherent subjectivity and piecemeal nature of ERF regulation is revealed by this question.
General Considerations		
1	What are the benefits and drawbacks of ERF versus GRC?	ERF benefits only utilities, while reducing incentives for cost control and effectiveness of regulatory oversight to the disadvantage of ratepayers.
2	How does ERF impact administrative and process burdens on Parties?	Stakeholders are unable to effectively participate in ERF cases. Due process is compromised in absence of complete filings, adequate discovery, uniformly updated costs and revenues and the inclusion of all needed adjustments to set fair, just and reasonable rates.