PPL
Second Suppl. Order

22.

The addition of construction work in progress (production and related transmission facilities only) to rate base proposed by the staff will add, after taxes, that level of earnings below which allowance for funds during construction has failed to yield the return on production and related transmission construction work in progress determined by this Commission as necessary to maintain adequate credit. The rate making cost of this adjustment is borne by the current ratepayer. A significantly greater amount would remain by staff adjustment to be borne by future ratepayers.

Counsel for the People of the State of Washington is concerned with the assessment of costs to current users of future service benefits; with the fact that acceptance of production and related transmission facilities, construction work in progress, in rate base may set precedent for future proceedings that make general construction work in progress inclusions inescapable; and that acceptance of the staff's proposal will remove a significant anti-inflationary brake on spending since the company controls its construction projects. In the opinion of the Commission, the assessment of a portion of the future service cost to present users is necessary and equitable. As to establishing future precedent, the rationale supporting the staff position is well thought out and permits inclusion of construction work in progress items in rate base only for major long term projects related to power production facilities.

For construction work in progress, Mr. Massey's evidence sets forth the Washington portion of total company major production plant and system transmission plant, deducting plant cost previously given proforma treatment, to derive an amount of $23,286,031 to be included in the Washington rate base. For allowance for funds during construction, Mr. Massey adds to the actual allowance for funds during construction for major production and system transmission a restatement amount reflecting the rate change (8 per cent) experienced on July 1, 1974, with a deduction for the interest applicable to certain plant previously given proforma treatment to derive a figure of $1,655,792 which is added back to operations. The proposed adjustments will be accepted.

Treatment herein accorded to construction work in progress constitutes a major departure from normal rate-making procedures in this state. We take this step only after the most serious deliberation as to its propriety. We recognize the concerns expressed by counsel for the people of the State of Washington. However, we do not agree that our treatment in this case can appropriately be advanced as a persuasive precedent in cases other than those involving electric utilities and then only as to those wherein it is demonstrated that construction work in progress is shown to represent a dramatic, increasing percentage of net utility plant. It is not the magnitude *per se* of construction work in progress, or the increase in the amount thereof, that warrants deviation from normal regulatory procedures. Rather, the problem arises from the coinciding of these two factors with construction work in progress becoming a soaring percentage of net plant. Deviation from normal procedures becomes justified where all those factors are shown to exist.

It also needs to be noted that those factors co-exist in the electric utility industry and during the period of transition from a relatively low cost hydro supply base to an energy supply base becoming increasingly dependent upon higher priced thermal production. Further, it is only major production plant, and associated transmission plant, that is being accorded this treatment. Increasing reliance on electricity as an energy source justifies

F. Market Rearrangement

The largest dollar adjustment at issue in the present case is one for a market rearrangement based on an expectation of declining sales by Cascade to ten large industrial customers. The proposed adjustment is intended to reflect anticipated sales for the year beginning April 1, 1978.

↓revenues

During the period before April 1, 1978, certain of Cascade's industrial customers made significant reductions in their natural gas usage. These customers have, as a group, increased consumption of alternate energy forms, notably residual fuel oil, a commodity currently in abundant supply, and, when compared with Cascade's interruptible natural gas, favorably priced. Inasmuch as the abundant supply and depressed price of residual fuel oil can be expected to continue in this region for at least two years, Cascade will not likely recover its lost industrial sales volume in the near future. Under these circumstances, an adjustment to test year results of operations is proper. The issue between staff and company is the amount of the adjustment to be made.

Mr. Beaudry, the company's special studies director, prepared, before October 1, 1977, a projection of expected sales losses to the company's 10 largest customers for the period from October 1, 1977, through March 31, 1979. Mr. Beaudry based his projection on conversations with officials of the ten customers and their estimates of natural gas usage over the period in question.

The projection indicated that the ten customers would undergo a transition period from October 1, 1977, to March 31, 1978, during which natural gas purchases would decline. The transition period represented the time needed by the customers to convert certain processes using natural gas to other forms of energy. After April 1, 1978, the projection indicated a comparatively steady rate of natural gas purchase by the ten customers, albeit at a significantly lower level than that experienced before the transition period. Cascade's proposed adjustment, reflecting a hypothetical sales loss of some 71 million therms, is concerned with the one-year period beginning April 1, 1978.

Since preparation of Mr. Beaudry's projection, several months have passed. The Commission has been provided with actual sales to the ten customers during the six months of the transition period, and also during April, 1978, the first month of the period represented in the adjustment. Staff urges the Commission to test the projection against actual results, and to modify the adjustment by a percentage equal to whatever composite inaccuracy may be contained in the part of the projection so tested. The company urges acceptance of the adjustment it proposed, contending that its projection is founded on actual contact with customers and is still most likely to occur. To guard

The company suggests that ratepayers do not pay debt service costs until new rates go into effect and that the accrual is a working capital accrual, that the treatment suggested by staff is contrary to Commission principle, that the funds come from eroded earnings, that power costs have inflated since 1976, and that the challenged item is a prepaid expense which will occur after the present case is closed.

Initially, the Commission commends the company for prudently seeking out, developing, and making available to its customers the substantial new source of hydro power which these generators represent. The enhancement of the company's ability to meet peak demand is consistent with the company's public service obligations.

More specifically, the Commission agrees that the item is, though not working capital, a prepaid expense and that it is an item which was provided by shareholders rather than by ratepayers. In so doing the Commission does not abandon the concept of upward or downward pro forma adjustments to rate base to reflect out-of-period events affecting major generating or transmission facilities in appropriate circumstances. The Commission also rejects as impractical any suggestion in the present case that implementation of new rates be bifurcated in time to coincide with the initiation of Rock Island debt service payments by Puget. The Commission adopts the company treatment of Rock Island power costs and rejects the staff proposed alternate treatment method.

E. Construction Work In Progress

To permit a company such as Puget to include construction work in progress in rate base is to authorize it to obtain from present rates and tariffs revenues specifically authorized for allocation to the financing costs of constructing major electric generating or associated transmission projects, the funds to be paid out before the in-service dates of projects so recognized. In recent years, each of the three investor-owned utilities in the State of Washington has begun a massive thermal generating facility construction program. Each utility in the course of its program has incurred unprecedented construction financing costs, and each faces the prospect of continued construction cost escalation for the foreseeable future. The Commission for over three years has recognized the companies' financial burden by permitting partial inclusion of construction work in progress in test year rate base.

The Commission had historically treated rate base as consisting only of plant actually in service, which is that plant used to provide present ratepayers with whatever service the particular utility furnishes. The Commission had likewise used rate base so defined to determine the amount of return permitted a utility's common shareholders. Beginning in Cause No. U-75-24 and continuing to date, however, the Commission has acknowledged the need for an exception to the historic definition of rate base in the case of electric utilities facing massive long-term construction expenditures for production and transmission plant.

on the ground that nuclear power is inherently unsafe and therefore imprudent. The Commission has no jurisdiction to determine the safety of nuclear as opposed to nonnuclear generation. The field has been preempted by the Federal Government and, consequently, the Commission will not address the question of safety.

Counsel for the public and intervenor POWER alternately contend that, should the Commission not exclude the entirety of construction work in progress from rate base, it should include only those CWIP costs associated with licensed and sited plants. The prime justifications for this position are (1) that licensing is a reasonable guarantee that a project will be built and therefore an assurance that the ratepayer's money will go to the proper expense, (2) that the licensing process serves as an independent test of the company's judgment as to siting, magnitude, design, need for, and timing of a project, and (3) that construction costs incurred before licensing are small in comparison to those incurred after licensing. The Commission is well aware of the special concern that attaches to any portion of a rate increase which is levied for exceptional circumstances, but must also consider the urgency of the ongoing construction program and the company's ability to finance that program without inclusion of CWIP in rates. The Commission has recognized the company's exceptional circumstances to assure adequate generating capacity for the future. The company's construction program has not been lightly undertaken, and the Commission sees in the company's effort an unbending commitment toward completion of the projects.

The second and third reasons advanced in support of including CWIP only for licensed and sited plants should be discussed in common as they are to some extent interrelated. The amount of funds required before licensing and siting a project is normally small in comparison to funds required between a project's licensing and its service date. Unavailability of a construction work in progress contribution at crucial early stages of a project's funding, however, risks impediment of the company's capacity to initiate financing and licensing procedures essential for the realization of needed projects. Given that the expenditures for licensing are small in relation to those which may be made after licensing any project, the Commission specifically determines that the added risk to those funds by virtue of their having been expended before licensing is outweighed by the assistance given to the completion of major construction projects.

In summary, the Commission recognizes that continuation of the company's construction program is necessary to assure adequate future generating capacity and that the company's ability to finance its construction program would be endangered absent inclusion of CWIP in authorized rates. Benefits to present ratepayers from inclusion of CWIP include stabilization of Puget's financial circumstances and present service capacity at a time when the company is undertaking a massive construction program to meet future service obligations, and the prospective avoidance of harsh cost increases after various in-service dates, as well as a general overall reduction in post in-service rates from that which could be expected absent present inclusion of

to represent a dramatic, increasing percentage of net utility plant.

In all electric rate proceedings since its decision in Cause No. U-75-24, the Commission has accorded CWIP treatment to rate base with the customary AFUDC offset. In the instant case, respondent seeks CWIP inclusion but no AFUDC offset. In the immediately preceding general rate case involving this company, Cause No. U-78-21, the company similarly requested a CWIP inclusion in rate base with no AFUDC offset. The Commission found in that proceeding that an effective increase in CWIP over the amount the Commission has heretofore authorized could not be permitted absent a showing that included as one element a demonstration that the company could not finance its construction program under the method previously adopted by the Commission.

In its rebuttal case in the instant proceeding, the company contends that retention of the present method of allocating CWIP would prohibit the company from not only earning a fair rate of return but would prevent the company from meeting the necessary coverage tests for future debt and preferred equity financings.

The attitude of the Commission in this proceeding remains unchanged from that stated in its order in Cause No. U-78-21----

> "the continuation of the construction program and the company's ability to finance that program, including its ability to maintain debt coverages, reflect generally on the company's ability to finance for present as well as for future customers.
>
> It is not arguable that plant in service is a more reliable object of funding than is a plant under construction, and service from projects under construction cannot now be flatly guaranteed. However, the likelihood of a needed project's being timely completed is influenced by a utility's ability to raise capital for the project and by a regulatory body's creating a climate which is not inhospitable to the funding of such necessary construction---"

Respondent's present financial needs are no less critical now than they were two years ago. The record in this proceeding shows that the company's financial position currently is in a state of deterioration which requires significant and immediate relief. It is obvious that continued application of the AFUDC offset will not provide the necessary internal cash earnings to permit the company to meet its necessary construction requirements as well as its several coverage tests.

After careful consideration of all the facts on this record and for the reasons stated hereinabove, it is the conclusion of the Commission that a portion of CWIP should be included in rate base with no AFUDC offset. In recognition of Puget's particular financial needs, 20 percent of total test year CWIP is determined as an appropriate amount allowable in rate base without the recommended AFUDC offset. The Commission policy adopted in this case is not necessarily intended as a precedent for future cases of this company or other utilities, but does represent in the Commission's judgment an action deemed necessary in responsibly meeting the obligations of this Commission to regulate the company in the public interest. The solution adopted herein is based upon the showing of a critical need for cash and total construction

5.

TABLE I
WASHINGTON NATURAL GAS COMPANY
RATE BASE-ACTUAL AND PRO FORMA
Calendar Year 1979
($000 Omitted)

	Company End of Period	Staff Avg. of Mo. Avg.
Utility Plant in Service	$240,113	$229,023
Completed Work Not Classified	9,388	8,217
Gas Stored Underground-Nonrecurrent	3,848	3,081
Less:		
Accumulated Provision for Depreciation	53,395	50,894
Contributions for Construction	1,580	1,546
Deferred Federal Income Taxes - Liberalized Depreciation	8,438	8,438 (1)
Add:		
Allowance for Working Capital	6,168	2,593
Rate Base-Actual	$196,104	$182,036
Adjustments		
Merchandising and Jobbing	(227)	(227)
Jackson Prairie	(479)	(491)
Inter Company Services	(36)	(36)
Reclassify AFUDC, Etc.	(481)	(406)
Miscellaneous Adjustments	-	3
Adjust Income Tax	14	14
Working Capital	1,679	(16)
Rate Base-Pro Forma	$196,574	$180,877

(1) End of Period

Respondent urges use of end-of-period rate base as a means of improving the company's prospects for earning its allowed rate of return. The company claims that since 1972 its revenues have remained consistently below levels allowed by the Commission in the seven rate orders which were issued during that period and which authorized successive increases in rate of return on average-of-monthly averages rate base.

Respondent attributes a utility's failure to achieve authorized return on average rate base to attrition, or the decline in rate of return which occurs during periods when costs of plant and operation rise more rapidly than the revenues generated by those costs. Respondent contends that ratemaking predicated on a year-end rate base mitigates attrition because year-end data more closely approximates post-rate-case conditions.

X

Respondent's exhibit 2, a graph introduced to prove attrition, shows continuous disparity between the company's authorized and actual rates of return between 1972 and the end of 1979. The data used in the exhibit are from the company's books without adjustment to revenue for weather, lobbying expense, organizational dues, or expenses chargeable to merchandising and jobbing operations, and without adjustment to rate base for items allocable to affiliated companies. Consequently, exhibit 2 does not reflect earnings or rate base calculated according to the methods prescribed in the rate orders governing the period surveyed and

NOI for the test period in the sum of $723,000. It was pointed out in our discussion of restating adjustment RA-2, Adjust Unbilled Revenues, staff adjustment properly matched income taxes between restated and pro forma gas costs. The staff adjustment here properly reflects the pro forma adjustment for increased unrecovered gas costs, and will be accepted.

E. P-4 -- Revenue at November 27, 1980 Rates

The purpose of this adjustment is to perform revenues and gas costs as of the company's most recent general order (U-80-25-27 4th Supplemental Order dated November 19, 1980) and commodity rate, respectively. The company's adjustment increased NOI by $2,928,000. The staff's adjustment increase NOI by $3,723,000. We will accept staff's methodology but, recalculate the adjustment to account for year-end customers resulting in an increase of $3,650,000 to NOI.

F. P-7 -- Depreciation Rate Increase

The company reduces net operating income by $1,437,000 and makes no adjustment to rate base.

The staff's position is that an adjustment to both rate base and results of operation is proper and thus reduces net operating income by $1,128,000 and rate base by $564,000. The Commission agrees with staff that an adjustment to rate base and results of operation is proper however, because we have adopted a year-end rate base the proper adjustment reduces NOI by $1,430,000, and correspondenly reduces rate base by a like amount.

G. P-11 -- Price Inflation Adjustment

The company's and staff's method of calculating this adjustment is in sharp conflict. The company made both a restating and pro forma adjustment for price inflation. The staff made a pro forma adjustment only.

The purpose of the company's restated adjustment was to restate its expenses not otherwise adjusted for the test year and is calculated as follows:

The company starting with its booked maintenance expense for the test year of $26,323,800 deducted $21,719,400 leaving a balance of $4,604,400 which it contends are expenses for materials and supplies not otherwise adjusted for during the test year and subject to inflation. Using an inflation rate of 6.4 percent (1/2 of the inflation rate of the Producer Price Index of 12.8 percent) results in a figure of $295,000. To that figure the company added $63,000 representing increased costs of high usage items of $792,247, resulting in a restated adjustment of $358,000.

The company's pro forma adjustment is made on the presumption that inflation will continue to escalate the costs of materials and supplies during the time the proposed rate will be in effect. The company's 10 percent inflation rate was derived mainly from opinions expressed in several financial publications.

The company's pro forma adjustment is calculated as follows:

1.	Materials and supplies not otherwise adjusted during the test year.		$4,604,400
2.	Restated adjustment		358,000
3.	High usage items		792,247
		TOTAL	$5,754.674
4.	Inflation rate		10%
5.	Proforma adjustment		$ 575,000

The Commission is satisfied that the company's sampling is both adequate and reliable and that a 10 percent inflation rate is not unreasonable during the time the proposed rates will be in effect. We will accept the company's adjustment.

H. P-12 -- Maintenance Expense

Both the company and staff made pro forma adjustments for repair and maintenance. The company included in its pro forma adjustment costs associated with resurvey of Class C leaks. The staff omitted these costs.

The company's adjustment is set forth in Exhibit 51 and is calculated as follows:

As of September 30, 1980, there were 3,552 leaks in 4 categories. These leaks will be corrected over a 4-year period averaging 880 leaks per year (assuming a 4-year average the proper figure per year should be 888). The company discovered 5,272 leaks during the test year for a total 6,152 leaks requiring repairs during the test year. The cost of repairing 750 leaks was capitalized and 4,177 leaks were expensed during the test year leaving a deficiency of leaks not repaired during the test year of 1,225. The estimated cost of repairing each leak is $490 resulting in a pro forma adjustment of $600,000 for repairs and maintenance of leaks in the 4 categories not repaired during the test year.

CLASS C LEAKS

As of October 1, 1980, the company had 5,926 leaks in this category. As of September 30, 1979, 4,283 leaks were in this category or a total growth of 1,653 Class C leaks during the test year requiring a resurvey at an estimated cost of $65,000. The company's pro forma adjustment for maintenance repairs and survey totaled $665,000.

Staff's adjustment (Exhibit 79, page 2) is based upon a backlog of 630 leaks requiring maintenance and repairs at an estimated cost of $435.61 per unit resulting in a pro forma adjustment of $148,194. Staff made no allowance for the resurvey of Class C leaks contending that such leaks are not part of the backlog requiring immediate attention.

be 15% with the resulting rate of return of 13.66% considered appropriate for use in arriving at the fair amount of coal expenses to be recognized for inclusion in respondent's Washington electric operations. We have restated this adjustment to reflect our conclusions resulting in an increase to the company's NOI of $253,000.

J. Weatherization Adjustment to Excise Tax

This adjustment prepared by staff only represents the reduction the company is entitled to take from Washington gross excise tax associated with the sale of certain weatherization items. We accept staff's adjustment increasing net operating income by $4,000.

K. Weatherization Investment

The staff's adjustment of this account accurately reflects the company's entitlement to the benefit of RCW 80.28.025. The company neglected to make provision for this adjustment. We agree with staff's adjustment which has the effect of reducing the company's net operating income in the amount of $10,000.

L. Attrition Allowance

As stated elsewhere in this order staff witness Louiselle recommended that the company be allowed to include an allowance for attrition adjusted to November 1982. He concludes the attrition allowance will afford the company the reasonable opportunity to earn the allowed rate of return in the first year rates resulting from this proceeding are in effect. The witness readily admitted that judgment is inherent in his analysis from which he draws his recommendations. This analysis is based upon likely or probable changes that can be expected in revenue, expenses and rate base that one can anticipate will occur from the end of the test period at December 31, 1980, to November 30, 1982.

We will not attempt herein to detail his studies and analysis in depth. A brief summary will suffice.

He first analyzed past growth in revenues (excluding growth due to rate increases), expenses and rate base and considered events that are likely to take place in the future which would affect the company's operation one year after the instant rate increases become effective. The revenue analysis is based upon growth in sales which is found to average 5.6% per year between 1974 and 1980. For the purpose of attrition allowance, the witness utilized a 5.5% annual growth in revenues. The study analyzed the company's past and anticipated growth for different categories of expenses. Findings of the average growth in expense categories are set forth in Exhibit No. 72, Page 8, 9, 10, 11 and 12. The analysis of rate base consisted of analyzing past and anticipating future growth. The analysis is detailed in Exhibit No. 72, page 13.

future growth

Based upon the estimated growth rates for revenue, expenses and rate base, the witness determined the rate of return the company will earn in the year ending November 30, 1982, which is the first year rates resulting from this proceeding will be in effect, calculated as follows. NOI will increase from $30,833,000 to $33,459,000. The rate base will increase from $268,077,000 to $356,000,997, resulting in a decrease in the rate of return from 11.52% (the rate of return recommended by the staff) to 9.37%, or a rate of attrition of 215 basis points over the 23-month period. The witness recommended, therefore, that an allowance of 2.15% is required to compensate the company for the attrition it will experience for the year ending November 30, 1982 and equals $14,807,000 in gross operating revenue requirement. The witness then adjusted the latter figure by the revenue compound growth factor of 1.1082 resulting in a recommended attrition allowance of $13,361,000 in gross operating revenue requirement.

The staff points out on brief that Mr. Louiselle projects that the company will by November 30, 1982, have approximately $75,349,000 of CWIP in the Colstrip project, an increase of $59,722,000 over December 31, 1980. This increase in CWIP accounts for $10,829,000 of the attrition allowance.

We have examined the testimony related to this adjustment with great care. Admittedly, attrition adjustments have been before the Commission in prior rate cases and have been rejected. However, both the circumstances we find in this case and the evidence in support of the adjustment are vastly different than what we have heretofore considered. It is clear on this record that the company's commitment to its construction projects to 1985, and its present program for major projects has created an imbalance in its ability to raise necessary construction funds from internal sources. This in turn has adversely affected the company's financial indices, upon which investors rely in examining the company's financial structure. Upon examination of the detailed analysis of Mr. Louiselle's testimony and supporting exhibits, we are convinced that in order to preserve and maintain the company's financial integrity and allow it to generate sufficient cash flow consistent with its needs for construction projects, and to attract investors at a reasonable cost, the staff's attrition allowance should be accepted. In accepting the attrition allowance proposed herein, we emphasize that such an adjustment for this or any other utility under our jurisdiction will be considered on a case-by-case basis only. We further state that the evidence adduced to support an attrition allowance must be of such a character that will lead us to a firm conviction that not to do otherwise will jeopardize the company's financial integrity and adversely affect the ability of the company to render required service to its customers at reasonable rates.

The Commission's findings on pro forma net operating income are summarized as follows:

Similar methodology

81%

D. <u>P-16 Rate Case Expense</u>

The staff by this adjustment reduces the company's estimate of rate-case regulatory fee expense because the Commission costs experienced in this proceeding will not exceed the level requiring further contributions by the company. On brief, the company accepts this adjustment.

E. <u>P-23 Tax Benefit of Pro Forma Interests</u>

This adjustment is proposed by staff to reflect the tax effects of the Commission's use of a pro forma level of debt expense in the analysis of the company's rate base. The company agrees on brief with the theory of the adjustment and the sole question here is as to the proper figure to relate to our determinations in the rate base section of this order. We have calculated the proper figure to be $6,089,422 and, consistent with the policy recommendations of the parties, will use that figure in our analysis of the company's results of operations.

F. <u>Attrition Adjustment</u>

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.

G. Allowance for Funds Used During Construction

The allowance for funds used during construction is an accounting procedure by which credit is made to the revenue account in order to balance entries made to the capital account of construction work in progress. This is an accounting adjustment only and does not reflect real revenues received by the company. The company accepts the staff adjustment, but it is based upon the staff recommendation that all CWIP should be included in rate base subject to a 9% AFUDC offset. Ultimately the adjustment sum would be capitalized and become a part of the CWIP capital total when the various projects become used and useful in utility operations and thus a part of the rate base.

We have above rejected the underlying staff recommendation, however, and in our treatment we have accepted only a limited sum of CWIP for rate base inclusion -- major projects WPPSS 3 and Colstrip 3 and 4 transmission facilities -- and we are accepting those without AFUDC offset. Therefore, we reject the recommended AFUDC offset adjustment.

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 analysis 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

	Growth	
Expenses	Company %	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.

B. Deferred Taxes

The company made no allowance for deferred taxes. The company maintains that the reserve for depreciation is not properly a rate base component. The Commission staff position is to the contrary, and consequently projects a 15% increase in the reserve for depreciation during the attrition period. The company has historically included the reserve for depreciation as a rate base item. The Commission concludes reserve for depreciation of deferred income taxes is a component of rate base. The 15% increase projected by the Commission staff is associated with growth in ACRS depreciation, and is accepted by the Commission.

C. Accumulated Depreciation

Both the company and the Commission staff made provisions for growth in accelerated depreciation. They both studied the period 1971 through 1981 to determine the year-by-year percentage growth and the trend rate of growth. The year-to-year

TABLE VII
PACIFIC POWER & LIGHT COMPANY
Authorized Rate of Return

	Capitalization Ratio	Cost Rate	Return
Long-Term Debt	52.40%	9.92%	5.20%
Preferred Stock	11.60%	9.93%	1.15%
Common Equity	36.00%	18.50%	6.66%
TOTAL	100.00%		13.01%

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

VII. REVENUE DEFICIENCY

In calculating gross revenue deficiency, it is necessary to recognize that weatherization program rate base elements are required under law to reflect a premium over otherwise authorized rate of return. The Commission has found that the appropriate rate base, less the weatherization program, for Pacific is in the amount of $303,157,000 and that the fair rate of return required by the respondent is 13.01%. The test year adjusted net operating income requirement, excluding the weatherization return, is $39,441,000.

The weatherization program rate base is $2,958,000, and the weatherization rate of return is 13.73%, resulting in a net operating income requirement for weatherization in the amount of $406,000. Therefore, the total net operating income requirement for the adjusted test year is $39,847,000. The adjusted net operating income for the test year is $32,084,000, and therefore the net operating income deficiency of the respondent is $7,763,000. In order to produce the gross revenue requirement, this figure is divided by .51332, the conversion factor agreed by the parties and accepted by the Commission as appropriate in this proceeding. The gross revenue requirement is $15,123,000. The attrition allowance found to be required by the company is $2,387,000, yielding a total gross revenue deficiency of $17,510,000, as shown in Table IX.

as to the amount of the reduction. The Commission staff claims that $14,756,000 should be the proper amount of utility interest expense which should affect taxes for utility operations.

The Commission accepts the Commission staff's position as to the proper treatment of interest expense in this adjustment. The rationale behind these changes is that the company should take into account only utility interest expense. The effect of this change is to increase federal income tax expense, thereby reducing net operating income by $905,000. (See RA-11, Inter-company Expense for related effect of the interest expense adjustment.)

E. RA-11 Inter-Company Expense

The company removed additional interest expense associated with non-utility operations in computing the amount of federal income taxes for this adjustment. The Commission staff claim s$1,968,000 should be the amount of the restating actual interest adjustment and that this change in company figures has already been taken into account in RA-5, Interest Expense Adjustment on FIT. Thus, the company's claimed interest expense adjustment has already been reflected in previous adjustments and should not be allowed. The Commission accepts the Commission staff's treatment of these figures as consistent with inclusion of only utility-related expenses in results of operations.

F. Price Inflation - Restating

The company proposes a 5% pro forma adjustment to expenses not otherwise affected by proposed changes in results of operations in order to allow for anticipated overall price inflation. This results in an $80,000 increase in the form of anticipated costs. The percentage is derived from the U.S. Department of Labor's Producer Price Index. Costs for high-usage items and samples of operating expenses in various areas were studied, which led the company to conclude that many actual expenses had experienced an inflation level beyond the 5% rate. Thus, an $80,000 amount was proposed to take into account increased costs not recognized elsewhere in the company's case.

The Commission staff rejects the company's pro forma and restating price inflation adjustments, citing a reduced inflation rate which may actually result in deflation of some costs. It is suggested that a moderate inflation rate can be offset by gains in productivity or cost control measures. The Commission staff further notes that such an adjustment does not take into account known and measurable factors.

The Commission accepts the view that the proposed price inflation adjustments do not represent a known and measurable factor. In addition, the Commission staff has made the downward adjustment of 42 million therms in RA-1 as an adjustment analogous to an attrition adjustment. This adjustment is specifically intended to help the company compensate for factors such as increasing expenses and decreasing sales.

G. RA-15 Property Tax

The company estimated 1983 property taxes by taking three-fourths of the 1982 amount and one-fourth of the 1983 estimated amount to arrive at an adjustment of $2,334,800. The Commission staff proposes using actual 1982 property taxes minus the

expense. In light of the record the normalization is accepted, but it is ordered that in Puget's next general rate case this issue will be discussed and presented under both methods so the Commission can then reach a decision as to whether or not interest expense will be accounted for using flow-through or normalization accounting methods.

The Commission's findings on pro forma net operating income are summarized as follows:

TABLE VII
PUGET SOUND POWER & LIGHT COMPANY
Results of Operations, Actual and Adjusted
for the Twelve Months Ended 6/30/82
($000 Omitted)

Description (A)	(B)
Net Operating Income - Actual	$113,049
20 Uncontested Adjustments	46,514
Contested Adjustments	
Power Supply Costs - Base	(2,515)
Power Supply Costs - ECAC	(30,973)
Pebble Springs Amortization	(4,749)
Pro Forma Interest	(24,711)
Net Operating Income Adjusted	$ 96,615

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.

VIII. COST OF SERVICE

The purpose of a class cost of service study is to determine the extent to which the various classes of services are

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

*Compound Growth Factor

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

IX. COST OF SERVICE

In Cause No. U-82-10, the Commission stated that there may be significant differences in customer class risk. To more accurately determine the relationship between individual class rate of return and the company rate of return, the company was directed to include a differential rate of return analysis as part of its cost of service study.

A. Risk Analysis

The company requested A. Gerald Harris, Vice President of Associated Utility Services, to perform a risk analysis study. The theory underlying the study is that the company's business risk is the combination of individual class business risks, and individual classes should be assessed a return requirement commensurate with their business risk. Mr. Harris developed rate of return factors, known as multipliers, which relate each customer

FINDINGS OF FACT

Having heretofore discussed both the oral and documentary evidence concerning all material matters inquired into, and having stated findings and conclusions, the Commission now makes the following summary of facts and conclusions. The portions of the preceding detailed findings and conclusions pertaining to the ultimate findings and conclusions are incorporated herein by this reference.

1. The Washington Utilities and Transportation Commission is an agency of the State of Washington, vested by statute with the authority to regulate rates, services, facilities, practices, rules, accounts, securities and transfers of public service companies, including gas companies.

2. Respondent Washington Natural Gas Company is engaged in the business of furnishing natural gas to customers within the State of Washington as a public service company.

3. On April 13, 1983, respondent filed revisions to its tariff WN U-2 which were designed to effect an increase in rates and general charges made by the respondent for gas service provided in the State of Washington. On April 20, 1983, the Commission suspended the operation of respondent's tariff revisions and ordered public hearings under Cause No. U-83-27 to consider the reasonableness and justness thereof.

4. The 12-month period ending December 31, 1982, is an appropriate test period to examine the operations of respondent for rate making purposes in this proceeding.

5. The average rate base for respondent's test year when adjusted pro forma is $222,037,000.

6. Authorization of gross revenue sufficient to achieve the rate of return of 12.34% on respondent's rate base will maintain respondent's credit and financial integrity, will enable respondent to raise sufficient new capital at reasonable rates to meet its service requirements and constitutes a fair rate of return.

7. The test year net operating income resulting from respondent's gas operations on a pro forma basis under the present rates is $24,695,000.

8. An annual gross revenue deficiency of $5,487,000 exists in test period revenues from respondent's operations calculated on a rate of return of 12.34% herein found appropriate, prior to consideration of any attrition allowance.

9. An attrition allowance to off-set projected irregularities and the effect of projected growth rates on the factors previously considered in the amount of $9,800,000 is appropriate.

10. The total revenue deficiency which is the sum of the two figures set forth above is $15,287,000.

11. The tariff revisions filed by respondent should be rejected and respondent should be authorized to refile revisions which will produce additional annual gross revenues not

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.

TABLE X
PACIFIC POWER & LIGHT COMPANY
ATTRITION REVENUE REQUIREMENT
(000 Omitted)

Weighted Cost of Capital	11.56%
Attrition Year Earned Return	10.86%
Attrition	.70%
Attrition Rate Base	$297,387
Net Operating Income Attrition	$ 2,082
Net to Gross Factor	.51175
Net Operating Revenue Attrition	$ 4,068
Compound Factor for Total Revenue	1.03415
Addition Revenue Requirement for Attrition	$ 3,934
Attrition Revenue Weatherization Loans	33
TOTAL Attrition Allowance	$ 3,967

VII. GROSS REVENUE DEFICIENCY

In calculating gross revenue deficiency, it is necessary to recognize that weatherization program rate base elements are required under RCW 80.28.025 to reflect a premium over the rate of return otherwise authorized. The Commission has found that the appropriate rate base, less the weatherization program, for the company is in the amount of $300,321,000, and that the fair rate of return required by respondent is 11.56%. The test year net operating income requirement is $34,717,000, excluding the weatherization return.

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.

? Some degree of future expectations

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.

C. Results of Operations Summary

Based upon the Commission's determinations of specific matters as set out above, the Commission concludes that the net operating income of respondent during the test period, as adjusted, is $53,702,000. Table IV shows the effect on respondent of adjustments to its actual income which have been found appropriate for ratemaking purposes.

TABLE IX

Pacific Power & Light Company
Net Operating Income Effect of the Results of Operation
Actual and Adjusted
($000 Omitted)

Description	Amount
Net Operating Income - Actual	$36,805
Uncontested Adjustments	$(1,852)
Contested Adjustments	
(5) Bridger	$ 1,185
(22) Interest Adjustment	(2,339)
(37) Abandoned Projects	0
Nuclear Plant Amortization	1,149
Total Contested Adjustments	$ (5)
Net Operating Income - Adjusted	$34,948

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.

No FORECASTED TEST YEAR

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.

Pro forma adj to historical data + attrition allowance risks double recovery

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[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

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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.

NEGATIVE ATTRITION

IX. REVENUE REQUIREMENTS

The Commission has found that the appropriate rate of return for the respondent's actual electric operation is 10.93% for the test year. Based on the following table, the Commission finds the respondent's gross revenue deficiency is $28,840,720. Table IX displays the computation of the gross revenue deficiency based upon a conversion factor of 0.5049378.

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.

PC

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).

VIII. JURISDICTIONAL ALLOCATION

As the company provides electric service to customers in six states including Washington, the company's joint facilities must be allocated to each of the states. During the pendency of this rate case, meetings were held among the staffs of the commissions of the states in which the company operates. The purpose of these meetings was to establish a new allocation method. As a result of these meetings, consensus was reached among company representatives and representatives of Washington, Oregon, California, Idaho, and Montana commission staffs regarding a transition from the old method to the new method.

The consensus was described in company witness Stephen Pearson's testimony to include the following points:

1. The "new Note 1" will be based 50 percent on demand and 50 percent on energy.

Table 5

WASHINGTON NATURAL GAS COMPANY
RATE OF RETURN SUMMARY

	Capital Structure	Cost Rate	Weighted Return
Long term debt	42.81%	8.72%	3.73%
Short term debt	5.50%	3.75%	0.21%
Preferred equity	7.69%	7.66%	0.59%
Common Equity	44.00%	10.50%	4.62%
Rate of return	100.00%		9.15%

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.

VI. GROSS REVENUE DEFICIENCY

The adjustments to operating income and rate base, when calculated with the Commission-approved capital structure and cost of capital, demonstrate that the company earns more than its authorized rate of return under current rates. The surplus amounts to $16,909,000[13]. The company will be ordered to reduce rates to produce the required reduction in revenues. Details are discussed below in Section VIII.

The calculation of actual revenue requirement from net operating income requires the application of a conversion factor. On brief, Commission Staff accepted the company's calculation of the conversion factor from exhibit 330 as 0.6083769542. In its brief, the company requested that the Commission take official notice of the increased corporate income tax rate (from 34% to 35%) and apply a recalculated conversion factor of 0.5991591216.

The Commission believes it is appropriate to recognize the increase in the corporate income tax rate to 35%. The company shall also consider increased revenues from its agreed equipment lease increases in calculating the revenue requirement reduction. The parties are directed to consult and recalculate the revenue requirement in this case including the appropriate conversion factor for the tax rate. The agreed revenue requirement should be noted and filed with the revised tariffs, along with a detailed portrayal of the calculation of both the conversion factor and the revised revenue requirement.

TABLE 6 Summarizes our calculation of the company's revenue requirement.

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[13] Subject to recalculation to recount for the new 35% federal income tax rate.