BEFORE THE WASHINGTON STATE UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the 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 THE ENERGY PROJECT

APRIL 30, 2019

I. INTRODUCTION

1 The Energy Project (TEP) files these comments in response to the Commission's Notice of Opportunity To File Written Comments, March 21, 2019. TEP filed Initial Comments on January 17, 2019, and attended the workshop on December 10, 2018.

2 The Commission's March 21 Notice focuses on the issues related to the Expedited Rate Filing (ERF) mechanism as a follow up to the recent PSE ERF docket,[1] which referred ERF issues to this proceeding. It is important to review ERF issues in the context of the broader discussion in this docket, including the initial "problem identification" which the Commission initiated and upon which it sought comment in the prior round. TEP's interest in this proceeding is to maintain a focus on the impact of alternative ratemaking proposals on residential low-income customers in Washington state.

[1] *Washington Utilities & Transportation Commission v. Puget Sound Energy (PSE 2018 ERF)*, Dockets UE-180899/UG-180900, Order 05, ¶¶40-41.

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II. COMMENTS REGARDING THE EXPEDITED RATE FILING MECHANISM

A. Policy Issues

1. Regulatory Lag

3 As an initial matter, TEP believes it is important to have a balanced view of regulatory lag. While the concept is often used perjoratively in current discussions by some parties, regulatory lag is not inherently harmful or negative. Regulatory lag is a neutral structural feature of rate regulation, meaning simply that a utility's authorized revenues remain fixed from one rate case to the next, creating a potential interval between incurring and recovering costs. An alternative term for regulatory lag might be "fixed revenue period" or "fixed revenue interval." Depending upon the company's financial situation during the interval between general rate cases (GRCs), this can either be beneficial or detrimental to the utility and its customers.

4 "Positive" regulatory lag, for example, allows a utility with strong earnings to exceed its authorized rate of return, allowing it to "stay out" of a rate case until the regulator seeks rate review or the company's fortunes change. This benefits the utility and its shareholders by allowing it to retain "excess" earnings for a period of time, but can be harmful to the ratepayers in the sense that they are paying higher rates than are needed to maintain a healthy utility.

5 "Negative" regulatory lag, the type most often cited as a problem by utilities in the current era, describes the situation where the utility's costs are not being covered by the authorized revenue level. This can be remedied by filing a GRC to increase rates and revenues, but there is an inherent delay or lag in bringing revenues in line with the increased costs. Even

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in this context, regulatory lag can play a valuable role in creating an incentive for utility managers to control costs in order to earn the authorized return. This replicates the competitive pressures a business faces in an unregulated market place, a primary function of rate regulation. This cost-control incentive is a valuable aspect of regulatory lag.

6 Regulatory lag is a built-in feature of rate regulation. An alternative system, in which all costs were tracked and passed through in customer rates more or less immediately, would create several problems. It would effectively result in a guaranteed rate of return for shareholders, while removing a significant incentive for a company to control its costs. Such a system would result in frequent and unpredictable rate changes for customers – eliminating rate stability. In addition, removal of financial risk to this extent should result in reductions in authorized rates of return on equity. If shareholder risk reduction is not reflected in rates, customers will pay more than is appropriate for service.

7 Importantly, this type of immediate cost-recovery system would not necessarily replicate a company's behavior in a competitive market. Unregulated companies in effectively competitive markets, even those facing increasing costs for some inputs, do not always increase prices to immediately pass through costs. Competition does not allow such behavior. Instead, companies generally try to keep prices for customers as stable as possible and as low as possible by managing costs, and by finding ways to offer lower customer prices than competitors so as to maintain or increase market share. Companies that are able to steadily and regularly increase prices without losing customers are most likely operating in an imperfect market where they exercise market or monopoly power. Regulated monopoly utilities, providing services that are

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essential for residential and business customers, do not face substantial competitive pressure as a control on price. Regulation protects customers by performing that function.

2. The Role of the ERF

8 The existence of regulatory lag, therefore, may or may not require any particular regulatory response in a given case, since it may not necessarily be harmful. If a response is called for, an ERF may in theory be a valuable regulatory tool to have available. The ERF mechanism must be clearly defined, however. TEP agrees with the testimony of Staff witness Chris McGuire in the recent PSE ERF docket observing that "without a policy framework for ERFs, and without a methodological approach informed by some form of thoughtful deliberation among the parties, ERFs will continue to be the source of angst and contention."[2] To date, the ERF has not been extensively used, nor have its working details been definitively set out. As a result, the ERF is presently of limited usefulness. If the mechanism is better designed and defined, however, it has the potential to be an effective and efficient tool to address "negative" regulatory lag.

9 Other mechanisms that address regulatory lag in different ways have been approved by the Commission in various settings. As TEP mentions in its opening comments,[3] a wide range of tools are currently in use including: purchased gas adjustments (PGAs), power cost adjustments (PCAs), end-of-period rate base, "power cost only rate cases" (PCORCs), pipeline cost trackers, and multi-year rate plans. The Commission also has the authority to employ an

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attrition adjustment, historically treated as an extraordinary remedy for periods of high inflation or unusually high plant investment. Finally, decoupling has been adopted for most companies as a revenue stabilization mechanism.

10 Assessing whether these different mechanisms are more effective and efficient ways to resolve regulatory lag than an ERF is a complex task. It is important to remember that all or most of these are already in place for most Washington IOUs and all operate to mitigate regulatory lag. These mechanisms by their nature, therefore, reduce the need for an ERF type mechanism in many cases. The need for an ERF in a given situation, and the parameters of the mechanism should be viewed in this context.

11 For example, multi-year rate plans are conceptually related to ERFs in that they build on an original GRC framework to allow incremental changes at set future times across the full rate structure. In this sense, a multi-year rate plan is an alternative to, and obviates the need for an ERF. If a multi-year rate plan is implemented after a GRC, TEP recommends that an ERF filing not be permitted during or subsequent to the rate plan, prior to the next GRC.

12 Regulatory lag has been cited as the reason for serial rate cases in Washington, and the Commission has invited parties to present alternative ratemaking mechanisms to help end this cycle.[4] The ERF has been offered as one such solution. It makes logical sense, therefore, that

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[2] *Washington Utilities & Transportation Commission v. Puget Sound Energy (PSE 2018 ERF)*, Dockets UE-180899/UG-180900, Testimony of Chris McGuire, Exhibit CRM-1T at 19:6-9.

[3] TEP Initial Comments, ¶31

[4] *Washington Utilities & Transportation Commission v. Avista*, Dockets UE-160228/UG-160229, Order 07 ¶¶ 76-77. ("breaking the pattern of annual rate filings")

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the filing of an ERF should require a commitment by a company to refrain from filing a general rate case for a minimum period of time, for example, until the end of the ERF rate year.

B. Threshold Criteria

13 TEP recommends that an ERF should not be used routinely, but rather in cases where regulatory lag is having unusual or especially harmful consequences. Regulatory lag, by definition, exists in every case as a practical matter, and is not in and of itself a basis for allowing an ERF. As noted, companies already benefit from multiple tools to mitigate lag. A company filing an ERF, therefore, should also be required to make an initial showing that it is experiencing substantial underearning for an extended period, for reasons that are likely to continue unless addressed. There should also be a showing that the factors causing the underearning are beyond the control of the company. Adopting these threshold criteria will preserve the positive incentive for the company to control costs.

14 TEP does not believe that a different standard should apply to rate determinations as between an ERF and a GRC. In either case, the rates which are ultimately paid by customers are required by law to be fair, just, reasonable, and sufficient. RCW 80.28.010(1), 80.28.020. Because the same legal standard applies, TEP believes the same basis should be used to set rates in either proceeding.

C. Methodology

15 TEP does not have extensive comments on the technical aspects of the ERF methodology and will defer to parties with revenue requirement experts. Regarding the conceptual

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framework, TEP recommends that the ERF continue to be seen as a way to update rates to reflect actual changes from a recent GRC based on known and measurable costs, rather than on budgets. Controversy and complexity should be avoided. In general, the parameters that have been discussed in prior dockets remain reasonable.[5] The ERF should not include new methodologies or new proposals, should not seek to change the cost of equity or capital structure, nor change the rate spread or rate design established in the underlying GRC. In addition, the ERF is not an appropriate proceeding in which to request a prudence determination for major rate base investments. The ERF mechanism, because of its expedited nature, does not allow enough time for parties or the Commission to engage in a realistic prudence review of major items. Accordingly, any recovery for new major plant investments allowed in the ERF should be subject to refund.

16 An ERF should be allowed within a limited period of time following a full GRC. A one-year deadline for filing an initial ERF request would be reasonable. A company should be allowed to file a maximum of two ERFs after a rate case before it files its next GRC. Finally, the ERF should be structured to ensure that the requested revenues do not exceed three percent, both in total and by customer class, so that the filing does not initiate a general rate proceeding under WAC 480-07-505.

[5] *Washington Utilities & Transportation Commission v Puget Sound Energy (2011 GRC)*, Dockets UE-111045/UG-111049, Testimony of Kenneth L. Elgin, Exhibit No. KLE-1T at 80:15-84:8

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D. General Considerations

17 As compared to a GRC, the ERF offers the advantage of being by design a more streamlined and less resource-intensive proceeding, which can provide a rate determination and rate relief for the utility in less time. Parties are not required to address contentious and complex issues such as cost of equity, rate design, or prudence of major investments. The ERF also has the advantage of being based on actual costs. The ERF has advantages over a multi-year rate plan in this regard, with rate changes being based on projections in the latter case. Setting rates in a GRC, with alternating ERFs between, may produce more accurate rates than multi-year rate plans, especially over the longer term.

18 The ERF can also have disadvantages. Because of its reduced timeline, it is more challenging for parties, especially those without in-house or retained expertise to conduct any required discovery or analysis. Although it is based on actual costs, because not all issues are addressed, the ERF can produce a less accurate rate determination than a GRC. From a customer perspective, the ERF produces another rate increase without the benefit of the complete review that occurs in a GRC. The GRC provides an opportunity to evaluate needed funding and policy changes for low-income bill assistance and weatherization programs which may not be as workable in the ERF context In addition, from the customers' perspective, the ERF introduces more rate instability, since absent the option of an ERF, a company filing serial GRCs may not be able to change rates as quickly as with an ERF.

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III. CONCLUSION

19 The Energy Project is generally supportive of the ERF as a potential tool for companies to address regulatory lag in appropriate situations. In order for it to be effective, however, as Staff has suggested, the parameters of the mechanism need to be more clearly defined than at present. The Energy Project may have additional recommendations or modifications to these proposals as the discussions develop. The Energy Project looks forward to working with the Commission and other stakeholders as this docket moves forward.

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