WASHINGTON UTC UTILITIES AND TRANSPORTATION COMMISSION

Ratemaking at the UTC

Presentation to the Washington Transportation Commission

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What the UTC does

Economic regulation

- Regulate private, investor-owned monopolies.
- Authorize changes in rates, terms, and service.
- Approve entry to some industries.
- Approve transfers of property and mergers.
- Enforce statutes and rules, assess penalties

Public safety

- Inspect rail crossings, pipeline and motor carriers for safety.
- Monitor insurance and register motor carriers.

Consumer Protection

- Resolve customer complaints and disputes.
- Investigate unfair business practices by companies.
- Educate consumers to make good choices.

Energy utilities we regulate

3 Electric Companies (45% of state electric customers)

- Puget Sound Energy (Western WA)
- Avista Corporation (Eastern WA)
- Pacific Power and Light (Southeastern WA)

4 Natural Gas Companies (996,000 customers statewide)

- Puget Sound Energy (Western WA)
- Avista Corporation (Eastern WA)
- Cascade Natural Gas (Across WA)
- Northwest Natural Gas (Southwestern WA)

UTC does not regulate – publicly owned electric utilities (e.g., municipalities, PUDs, cooperatives), Bonneville Power Administration (BPA), interstate pipeline operators.

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Our statutory mandate

RCW 80.28.010 and 81.28.010: rates charged by companies that the UTC regulates must be "**fair, just, reasonable and sufficient.**"

How we interpret that mandate:

"***fair*** to customer and to the Company's owners; ***just*** in the sense of being based solely on the record developed in the proceeding following principles of due process of law; ***reasonable*** in light of the range of possible outcomes supported by the evidence and; ***sufficient*** to meet the needs of the Company to cover its expenses and attract necessary capital on reasonable terms."

PSE General Rate Case, Docket UE-0-0904, Final Order, Order 11 (April 2, 2010).

General rate cases

RCW 80.04.130:

- The commission may suspend proposed rate increases
- Just and reasonable standard
- Company bears the burden of proof

The commission's role:

- Review the testimony of the company, staff and, as applicable, other intervening parties
- Determine fair and just outcome based on evidence in record
- In settled cases, review and approve settlement – public interest

General rate cases vary in complexity. A rate case for a small water company may only require one staffer and be resolved in a matter of hours or days. A rate case for an energy company usually requires 6-10 staffers and the full 11 months allowed in statute to be resolved.

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Overview of the ratemaking process

The UTC's ratemaking process follows three steps:

- **Revenue requirement:** How much money will the company need to cover its costs and earn a fair return?
- **Cost-of-service study:** How should the revenue requirement be divided among the company's different classes of customers?
- **Rate design:** How can we set rates for each customer class to ensure that it pays for its share of the revenue requirement?

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Revenue requirement

Central question: How much money does the company need?

The answer: A simple formula with complex inputs:

$$\mathbf{R = O + B(r)}$$

Where:

R is the revenue requirement;

O is the company's operating expenses;

B is the company's rate base; and

r is the rate of return allowed on its rate base.

Key principle: A company must demonstrate that an asset or expense is "used and useful" in providing service before recovering its costs from customers. (RCW 80.04.250)

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Cost-of-service study

Central question: Who pays for what?

Three components:

- *Functionalization*: What are the company's different functions, and what costs are associated with each function?
- *Classification*: Within each function, what services are provided and what are the costs associated with each service?
- *Allocation*: Now that costs have been functionalized and classified, what metrics will be used to split them among customer classes?

Key principle: Cost causation. The company's expenses should be recovered only from the customers that caused those expenses to be incurred.

Rate design

Central question: What rates ensure recovery of a class' costs, based on that class' usage?

Historical test year: Data on how different classes used services over a 12-month period informs the allocation process and provides the denominator in the ratemaking formula:

Rates = Target revenue / Units

Rate design presents an opportunity to use price signals to encourage more efficient usage. Some considerations:

- Discouraging use during peak periods
- Encouraging use during off-peak periods
- Incenting alternative technology usage and development

Key principle: Gradualism. Rates should not be subject to wild swings.

Integrated Resource Planning

The UTC requires energy companies under its regulation to submit an **integrated resource plan (IRP)** every two years.

In an integrated resource plan, a company:

- Projects demand for the next 20 years;
- Analyzes all available resource options for meeting that demand;
- Analyzes how different resource mixes (portfolios) perform under different scenarios related to weather, demand growth, resource costs, etc. (sensitivity analysis);
- Identifies the portfolio that meets future needs under a variety of circumstances at the lowest reasonable cost; and
- Makes an action plan for meeting needs identified for the next three years.

Each company prepares an IRP every two years and submits it to the commission for acknowledgment (not approval).

Questions?