

BEFORE THE PUBLIC SERVICE COMMISSION OF WYOMING

In the Matter of the Proposed Revision of)
§§ 249 and 250 of the Commission's)
Procedural Rules and Special Regulations)

INITIAL COMMENTS OF THE
WYOMING OFFICE OF CONSUMER ADVOCATE
(Filed: January 27, 2005)

The Wyoming Public Service Commission (Commission) has stated its intention to modify §§ 249 and 250 of its Procedural Rules and Special Regulations. In anticipation of a formal rulemaking proceeding, the Commission has offered interested parties the opportunity to submit initial suggestions regarding the language and content of the pass-on and Commodity Balancing Account rules and procedures. The Office of Consumer Advocate (OCA) appreciates this opportunity to provide input to the Commission while the rule revisions are still in their formative stage. Our specific suggested modifications to Rules 249 and 250¹ are attached to these comments, while the comments themselves offer some of the underlying reasons and need for our suggested changes.

Distinguishing Rule 249 from Rule 250

At the January 13, 2005, Technical Workshop that the Commission sponsored to allow for a discussion of the potential changes to the rules, the greatest discussion occurred regarding the financial information that should be submitted by an applicant requesting a pass-on, and the potential action that might be taken by the Commission depending on what that financial information shows. As a result of that discussion, many of the public utilities, as well as others in attendance at that workshop, seemed to have determined that there was a need to completely distinguish the use of a “pass-on” from the use of a “Commodity Balancing Account” and thus, to completely distinguish the

¹ Our comments begin with the text from the proposed rules that the Commission recently issued for comment and then withdrew from a formal rulemaking proceeding. The type in red strikethrough represents the language that we recommend be deleted. The blue underlined language represents the language that we propose be added.

requirements and purpose of each of those rules. We believe any attempts to emphasize the differences between “pass-ons” and “pass-throughs” should be rebuffed, as they are simply attempts to soften the requirements for one group of utilities. While we do not object to two rules (one for those companies without a Commodity Balancing Account and one for those with a Commodity Balancing Account) the requirements of both need to be carefully reviewed. Hence, to be consistent with the format that we expect you will receive from others, we have submitted our initially proposed language in two self-contained rules. However, many of the concepts of each rule are similar.

Specifically, we disagree with the earlier proposed rule that would have required all public utilities that wished to pass-on changes in commodity or commodity related costs to also have a Commodity Balancing Account. There are times when it is appropriate that a public utility be permitted to reflect in on-going rates, without an additional tracking mechanism, the increased or decreased wholesale commodity cost. The classic example, and one that is still relevant, is the wholesale power rate change that occurs when a generating cooperative (e.g., Tri-State) changes its wholesale power rate to the distribution cooperatives. This is a rate change that is generally announced with some advanced notice and with certainty, so that those cost changes can readily be incorporated into the retail rates of the distribution utilities. Most of the distribution cooperatives have found little or no need for a Commodity Balancing Account and this opportunity for a pass-on without further true-ups or single-item cost tracking should continue to be offered to them. We are opposed to a rule that would require all electric cooperatives to have a Commodity Balancing Account. It should be a case-by-case, company-by-company decision.

The Burden of Proof

Both the Commission’s proposed rules and current rules reference that applications for pass-on rates and Commodity Balancing Accounts must abide by the rate and tariff requirements of W.S. § 37-3-106. We are pleased that this continues to be part of the rule, and encourage the Commission to keep this very specific statutory reference

in Rules 249 and 250. We especially note the text of W.S. § 37-3-106(a) which states that “At any hearing as provided in this act involving an increase in rates or charges sought by a public utility, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the utility.” We find that this concept is sometimes forgotten, as some of the utilities have tried to place the burden on those protesting the increase. Thus, it is important that the utilities be explicitly reminded that the burden is theirs.

This issue is particularly important as more and more pass-on applications and balancing account amortizations are approved using the “*notice and order*” process. Under this process, the Commission will notice interested parties that the application has been filed, and allow for a period of time in which the interested party may protest or request a hearing. However, during this time frame, the application has already been approved and the new rate is in effect. It seems that the utility should continue to bear the burden of supporting the rate increase, especially under this process that greatly benefits the utility, since the rate change is put into effect before many parties are even aware that the application has been filed. Yet, some have argued that once the order is approved, even on a notice and order basis, the burden shifts to those protesting the application. This is patently unfair to the public and does not meet the spirit of the law relative to noticing requirements. Thus, the OCA recommends the rules clarify that the burden of proof continues with the utility throughout the proceeding, not just through the time that the Notice and Order is issued. Alternatively², the Commission could discontinue the use of the Notice and Order process relative to pass-on and Commodity Balancing Account applications and notice all applications before they are brought to the Commission for approval in an Open Meeting. This would remove any doubt about who bears the burden of proof in these cases and assure that interested parties are allowed an adequate opportunity to become aware of the filing and familiarize themselves with the application prior to its approval.

² We have suggested language consistent with the suggestion to clarify the burden of proof but not for our alternative language. However, this alternative language could be incorporated by simply changing the opening paragraph of Rule 249 to read, “...Pass on applications under this section may be authorized, after public notice and opportunity for hearing, if the evidence of record shows...”

Financial Showing

The Commission's earlier proposed rules offered some very specific and detailed financial reporting requirements to be incorporated into a public utility's pass-on application. While we agree that a financial showing is necessary to assure that a public utility's overall rates remain just and reasonable, the OCA offers an alternative means of making the showing. With the OCA alternative, a public utility has more flexibility in what supporting documents it chooses to submit while the burden of demonstrating that the request is appropriate remains squarely on the public utility's shoulders.

The financial showing should remain an integral part of the Commission's rules. At the technical workshop, and the group meetings that followed, several utilities indicated that a financial showing was only important if the change in rates was being passed through, on a permanent basis, without a tracking or true-up mechanism. We strongly disagree. The tracking and true-up mechanism will only provide comfort regarding the comparison of actual versus projected costs and revenues versus costs. It does nothing to assure that the utility is not earning at excessive or unreasonable levels.

In general, the pass-on rule and Commodity Balancing Account rule allow a public utility the opportunity to expedite recovery of a significant portion of its operating costs with a very focused and limited review at the time of the rate change. However, this expedited process must still protect the public interest and the Commission must continue to assure that rates remain just and reasonable.³ The earnings review assists in

³ Just and reasonable is a standard found throughout the Wyoming statutes in reference to utility rates. Notably, W.S. § 37-2-121, states, "If upon hearing and investigation, any rate shall be found by the commission to be inadequate or unremunerative, or to be unjust, or unreasonable, or unjustly discriminatory, or unduly preferential or otherwise in any respect in violation of any provision of this act, the commission may fix and order substituted therefor such rate as it shall determine to be just and reasonable and in compliance with the provisions of this act." Furthermore, 37-2-122(b) states,

If, upon hearing and investigation, any service or service regulation of any public utility shall be found by the commission to be unjustly discriminatory or unduly preferential, or any service or facility shall be found to be inadequate or unsafe, or any service regulation shall be found to be unjust or unreasonable . . . the commission may prescribe and order

this process by allowing the Commission, and the utility, to assure customers that the expedited process will not result in excessive or unreasonable levels of earnings (i.e., monopoly profits). The Commission should set the earnings test that will be used (e.g., measurement of return on equity) but should allow the public utilities some flexibility in the level and format of the support provided to make that showing. Keeping in mind that the utility bears the burden of showing that it has met the financial test set forth by the Commission, the Commission should assure that adequate support is provided regarding the financial test(s) set forth in the rules before additional rate increases are permitted through pass-on procedures. The OCA does not believe that the exact same set of forms and work-papers are required by each company for each to make an appropriate showing that both rates and earnings are reasonable, even if the pass-on is approved.

For example, Company A may be earning a 5% return on rate base and a 7% return on equity, on a Wyoming normalized basis, as well as a 5% return on rate base and a 6% return on equity, on an actual per books basis. If the authorized return on equity is 10.5%, the *prima fascia* case that excessive earnings are not occurring might be made with limited supporting documentation. However, if Company B is earning 12% on its Wyoming rate base, and a 14% return on equity, and its last authorized return on equity was 13%, the normalized numbers and supporting documentation become much more important. The numbers and documentation are important to interested parties in making their decision to intervene and important to the Commission in making its decision to approve the pass-on. Thus, Company B should consider a clear and concise means of showing its normalizing adjustments and pro forma earnings in order to meet its burden of demonstrating that its rates and earnings levels remain just and reasonable.

The OCA is recommending that the best and most useful earnings test to be incorporated into the pass-on rule is the level of return on equity and whether the currently computed, normalized return exceeds the return on equity that was last

substituted therefor such service, facility or service regulation, as it shall determine to be adequate and safe, or just and reasonable...

authorized in the establishment of the company's base (non-commodity) rates. This is opposed to a test on the less meaningful overall rate of return (e.g., return on rate base or return on investment). The return on equity is more indicative of whether shareholders are earning excessive profits. The following example shows how a return on equity can change dramatically, and can be much higher than the authorized return on equity, while the return on rate base remains below the currently authorized level:

CAPITAL STRUCTURE AT TIME OF RATE CASE				
	Capital Dollar Amount	Percentage of Overall Capital Amount	Cost	Weighted Cost
Debt	\$40,000,000	40%	7%	2.8%
Preferred Stock	\$5,000,000	5%	8%	0.4%
Equity	\$55,000,000	55%	12%	6.6%
TOTAL	\$100,000,000	100%		9.8%

CAPITAL STRUCTURE AT TIME OF PASS-ON				
	Capital Dollar Amount	Percentage of Overall Capital Amount	Cost	Weighted Cost
Debt	\$60,000,000	60%	6.5%	3.9%
Preferred Stock	\$0	0%	0%	0%
Equity	\$40,000,000	40%	12.75%	5.10%
TOTAL	\$100,000,000	100%		9.0%

In this example, the rate case authorized return on rate base is 9.8% and the authorized return on equity is 12%. Some time later, without an intervening rate case having occurred, an earnings test is performed. It shows that the company is earning less than its authorized return on rate base (9% versus the authorized 9.8%). However, even

with lower overall earnings, the utility's shareholders are now earning a higher return than was authorized as reasonable. This phenomenon is caused, in the example, by a change in the capital structure accompanied by a change in the cost of debt financing.

If the pass-on rules used an earnings test of the overall rate of return, rather than the return on equity, there could be adverse, unintended impacts. Specifically, the utility's shareholders could be permitted to have an increased return on equity, without any review of comparable companies' earnings, market and general economic conditions, or changes in the utility's risk. As a result, the pass-on would become more than a limited opportunity to collect a narrowly defined set of costs on an expedited basis.

The question has recently arisen as to whether the authorized returns set in rate cases are caps or targets. Under traditional, return-on-rate-base regulation, the only reasonable answer is that they constitute caps. Consider the following example.

Assume that Company A has rates set in "Year One" based on the following findings:

Rate Base	\$50,000,000	
Operating Revenues	\$10,000,000	
Operating Expenses	\$ 5,500,000	
Operating Profit	\$ 4,500,000	
Capital Structure:		
Debt	\$25,000,000	at 8%
Equity	\$25,000,000	at 11%
Return on Rate Base		9.5%

Assume that in "Year Eight," the normalized financials for Company A show:

Rate Base	\$65,000,000
Operating Revenues	\$15,000,000
Operating Expenses	\$ 8,825,000

Operating Profit	\$ 6,175,000	
Capital Structure:		
Debt	\$39,000,000	at 8%
Equity	\$26,000,000	at 11.75%
Return on Rate Base		9.5%

Company A is recovering its increased operating expenses and is paying its cost of debt on a larger principal amount while still earning the same percentage return as it was authorized on its larger rate base. Meanwhile, it is exceeding the return on equity that was used to set its rates. Since all other costs are being covered, this money is going directly to shareholders, either in the form of added value in the company or in the form of dividends. Shareholders are receiving additional benefits without a Commission determination that such an increase is just and reasonable. If shareholders were only allowed to earn the authorized 11% return on equity, rather than the actual level of 11.75%, and no other adjustments were discovered that needed to be made to the Company's reported figures, there could be a nearly two percent reduction in customer rates.⁴

Company A could argue that equity costs have increased in the capital markets and thus, the increase in the earned return is reasonable and rates should be left alone. This may be the case. However, that is not the type of decision that should be made in a pass-on or Commodity Balancing Account proceeding without further investigation, evidence and a hearing. It must not be made on less than thirty days notice which is the time that normally elapses between the date of a filing and the date of a Commission decision at an open meeting. It is normally a highly contested issue in rate cases. It is important to the determination of whether or not rates are just and reasonable.

⁴ The overall return would be reduced by 30 basis points. When the 30 basis points are multiplied by the \$65 million rate base, the result is a necessary reduction in earnings of about \$195,000. This earnings reduction is then multiplied by the tax gross up factor to arrive at the amount of the revenue reduction, which is about 2% of the \$15 million of current revenues.

Wyoming statutes call for rates to be just and reasonable, so there must be a guidepost against which to make that determination. Without such a guide, there would be no way to determine the appropriateness of the rates. Rate of return, based either on rate base or on equity, has historically been that guidepost. The level of earnings, measured not in absolute dollars but as a ratio, provides a way to test whether a utility is earning an unreasonable level of profit like a monopoly might be able to extract from customers without oversight or regulatory restraints. If a utility were allowed to earn returns that exceeded the authorized levels, the point of regulatory oversight would be moot. Regulators would also not be doing their jobs of being a surrogate for competitive markets that make sure that no one firm is able to earn unreasonably high returns relative to its competitors.

Historically, rate of return has been the benchmark, and for good reasons. Returns can, and are, readily compared to the returns earned by comparable firms with comparable risks in the market. Returns are measurable. As a surrogate for competition, regulation should only allow the kinds of earnings that investors would demand of other, similarly situated companies. The United States Supreme Court established the return on equity standard long ago in the “Hope and Bluefield” cases. In *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591 (1944), the court found:

The rate-making process under the Act, i.e., the fixing of 'just and reasonable' rates, involves a balancing of the investor and the consumer interests. Thus we stated in the *Natural Gas Pipeline Co.* case that 'regulation does not insure that the business shall produce net revenues.' (315 U.S. at page 590, 62 S.Ct. at page 745.) But such considerations aside, the investor interest has a legitimate concern with the financial integrity of the company whose rates are being regulated. From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. *Cf. Chicago & Grand Trunk R. Co. v. Wellman*, 143 U.S. 339, 345, 346 S., 12 S.Ct. 400, 402. By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.

In *Bluefield Waterworks Improvement Co. v. Public Service Commission of West Virginia*, 262 U.S. 679 (1923), the court held that:

A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public **equal** [emphasis added] to that generally being made at the same time . . . on investments in other business undertakings which are attended by corresponding risks and uncertainty

The *Hope* and *Bluefield* cases, as referenced above, stand for the proposition that rates established by regulators cannot be confiscatory in nature. Other cases, such as *New England Telephone and Telegraph Company v. Department of Public Utilities*, 275 N.E. 2d 493, recognize the existence of a “range of reasonableness” into which rates must fall. It stands to reason that a “range of reasonableness” must have boundaries. One end of this range would be rates which are confiscatory, while the other end of this range would be rates which exceed an authorized return. Rates should not be set at or below a confiscatory level, nor should they be set above the level of the authorized return. By definition, rates which produce returns falling outside of this range are not reasonable.

These decisions, and others, firmly establish the return on equity as a cap above which the earnings of a company are inconsistent with returns being earned by investors in investments of similar risk in the same general time frame. The same cannot be said of other potential benchmarks that others have suggested over the years. For example, some have suggested that a water company’s rates are unreasonable simply because they are higher than all of the other rates for water companies in the same geographic area. However, the Commission has consistently rejected this argument, based on differences in operating factors, customer density, quality differences, and numerous other relevant factors.

Some may argue that the rate of return cannot and must not be the guidepost of reasonableness under incentive regulation, performance-based regulation or non-traditional regulation. Perhaps that will be proven true, if and when any non-traditional regulation is adopted by the utilities and/or the Commission. This is not a current problem. No electric or gas public utility has proposed or implemented an incentive

ratemaking concept in Wyoming. If one does, the Commission may address it through the proposed language that allows for exceptions when spelled out in advance. This is precisely the type of situation where the exception to the financial aspects of the pass-on rule may make sense. However, it should be done well in advance of a pass-on filing, so that the ground rules are not changing under an interested party's feet.

The OCA's proposed language changes also anticipate the circumstance where a utility may not have an authorized return on equity. Some of the rates for water companies are set using an operating ratio or other financial parameter other than a rate of return. Some of the electric distribution companies have rates that were based primarily on times interest earned ratios (TIER) rather than returns, and in some cases, the rate of return may not be specifically authorized in older rate orders. There must be another way of measuring the financial reasonableness of pass-on requests for these companies.

This raises the question of what happens if a showing is made that a public utility is exceeding its authorized return on equity or other relevant financial parameter. The Commission has two options to remedy the over earnings and ensure that the company's overall rates remain just, reasonable, and consistent with the public interest. Our recommended option is to retain the Commission's historic practice, as articulated in the current rules, of reducing the pass-on amount in proportion to the demonstrated excess amount of earnings. The other option would be for the Commission to adjust the company's base rates to correct the excess earnings. However, in order to do so in a timely manner, it would be necessary to suspend or make interim the existing base rates in order to avoid the accumulation of excess earnings to the benefit of shareholders during the pendency of a base rate investigation.

While we believe the Commission has the authority to do this pursuant to W.S. § 37-2-121, we believe that this section of the statutes also gives the Commission authority to reduce the pass-on amount to bring it in compliance with that authorized by the Commission. We further believe that the former option is a more accurate and expedient

method of adjusting earnings as it would not entail a full rate case investigation. Upon a determination by the Commission, based on a *prima facie* showing by a utility or an interested party, that the company is exceeding its authorized return, and following a Commission adjustment to the pass-on amount to reduce the company's return to the authorized level, the company would be free to initiate a general rate proceeding, in which it would bear the burden of proof, to justify its current rates including the full amount of the pass-on. This allows the overall rate charged by the Company to remain at just and reasonable levels.

During the technical conference on January 13th, much attention was given by the industry participants to the need to reduce regulatory lag with respect to fuel and purchased power expenses as these expenses are a large portion of the operating expenses of utility companies. The Commission should be mindful of the fact that regulatory lag is a two-way street. The Commission must recognize that a failure to address excess earnings at the time of a pass-on request would subject customers to unreasonable rates for as long as it takes the Commission to make a determination regarding the base rates of the company. In the end, it is the Commission's statutory obligation to ensure that a company's rates are just and reasonable whether those rates are determined through a general rate case proceeding or through a pass-on proceeding.

Types of Costs Allowed to be Passed-Through

As proposed, there appear to be some inconsistencies, or at least some potential conflicts, with various phrases in the proposed rules, specifically as they relate to the types of costs allowed to be passed-through the Section 249 mechanism. For example, as proposed by the Commission, the rules indicate that only commodity costs and commodity-related costs that are "not under this Commission's jurisdiction" may be included in the pass-on. A list of example items then follows. One of the items on the list is "fuel costs" and another is "storage costs". In some cases, such as when the public utility owns the fuel supply or the storage field, it would be difficult to see how these costs would be "not under this Commission's jurisdiction," especially if they have been

subject to Commission review in establishing retail rates. The question then is raised as to whether or not these costs should be included in pass-on applications.

The OCA urges the Commission to keep the discretion to allow such costs in the pass-on. As debated before the Commission in a recent PacifiCorp pass-on request, if purchased power costs are allowed but fuel costs related to self-generation are not, there could be disincentives to run company-owned generation plants. Even if the production costs of self-generation were less expensive than the costs of purchasing power, the decision could be swayed by the ease of recovery of one set of costs versus another. Disincentives of this nature should be avoided as much as possible.

The OCA also encourages the addition of some language to Section 249(a) in order to again keep some flexibility in the types of costs that may be appropriate to include in a pass-on mechanism. This suggested language would require the utility to describe the types of costs that it wishes to pass-on, as well as support why those costs are appropriate for this unique ratemaking treatment. However, others should also be able to suggest costs to be included in the pass-on, along with reasons as to why those additional costs should be included. For example, a utility may propose to include the cost of a financial hedge in the pass-on cost, but may fail to include any revenue received as a result of that same hedging transaction. In this example, an intervenor could request that the associated hedging revenue also be included in the pass-on, without having to convince the public utility to make such a request.

There should, however, be some boundaries to the types of costs that can be included. Consequently, we suggest that the costs be limited to *commodity or commodity-related costs*. This would allow for a great deal of flexibility regarding the types of costs most commonly included in narrow, expedited review mechanisms, such as pass-ons, but would prevent public utilities from adopting a *kitchen-sink* approach.

We also suggest that the Commission not include the language “including, but not limited to” when providing a list of the costs that might most commonly be included in a

pass-on. This language is too limiting, in that once an item is on the list, it could be reasonably argued that it must be included in the pass-on, regardless of considerations of the public interest, affiliate transactions, ownership, or other circumstances. Instead, we suggest language that provides these items as examples, not mandates.

Adoption of the OCA's recommended language would not, in any way, change what is subject to Commission jurisdiction. At the technical workshop, some concern was expressed by a representative of one of the distribution cooperatives that removing the phrase "not under this Commission's jurisdiction" could change the current regulatory scheme of regulating the distribution cooperatives but not the generating and transmission cooperative. There need be no worry about this, since nothing in this rule changes the Commission's overall authority. All that would be changed would be how certain costs are recovered for ratemaking purposes. Again, we urge flexibility in this regard and retention of the Commission's discretion.

Equal and Proportionate Allocation of Increases and Decreases

Proposed Section 249(c) requires that that pass-on related changes in rates be allocated to all customer classes, including contract customers, on an equal or proportionate basis. The proposed rule then goes on to allow for an exception based on special circumstances wherein a dedicated commodity source is used and other defined arrangements are present. The OCA agrees with the idea that all customers, including contract customers, should share in the burden or benefits of the pass-on. However, as an option, it would be reasonable to allow the utility the option of absorbing the portion of the rate change that would normally be allocated to contract customers if a disagreement occurs between the contract customer and the utility as to whether the contract language allows such a pass-on. In no event, however, should a contract customer's share be assigned to other customer classes.

The OCA does, however, recommend that transportation-only customers (customers who purchase 100% of their own commodity and simply transport it over the

utility's facilities) be specifically released from having to pay a share of increase or decreases in commodity or commodity-related costs. These customers do not cause or benefit from these commodity and commodity related costs and thus, should not be responsible for paying them.

As to the proposed language regarding exceptions, the OCA recommends an alternative means of addressing any necessary exceptions. Rather than trying to spell out the exceptions and providing incentives for the creation of such exceptions where none now exist, generic language should be used that once again reminds the public utility of its burden to specifically show why the general standard is not in the public interest. If unique circumstances arise, which we anticipated would be very limited in scope and number, a public utility may bring that unique circumstance to the Commission for a ruling. Otherwise, the general standard is appropriate and should be followed. Our recommended alternative language is found in Section 249(c).

The Commission's proposed text of Section 249(c) also includes a requirement that "the fundamental rate design relationship previously approved by the Commission" be maintained as a result of the pass-on surcharges, and that surcharges or credits be applied "equally or proportionately to all service schedules and to each of the commodity components of the current rate design." The OCA is concerned about whether all of these goals or mandates can be accomplished simultaneously, since we believe that some of them may be mutually exclusive. We are also concerned about the level of effort and associated costs that are likely to be involved with implementing each of these mandates.

When considering this issue of maintaining the established rate design relationships, we remind the Commission that there are more than two essential cost categories that underlie rate design determinations. The proposed rule leaves the impression that rate design only addresses commodity related costs and non-commodity related costs. This is too much of a simplification of the cost categories, and fails to recognize that commodity costs are comprised of both demand and energy components (for electricity) and transportation and commodity components (for natural gas). These

underlying cost categories are recovered in different cost elements for different customer classes.

Additionally, different areas within a company can have different means of collecting various cost elements. One example involves the Kinder Morgan system. In the Gillette area, the costs of transporting the gas are paid to a third party who owns the pipeline, and those transportation charges are included in the volumetric (per therm) charge for natural gas. However, in the Casper area much, if not all, of the transportation system is owned by Kinder Morgan. Thus, recovery of these charges is done through the distribution charge, rather than the commodity charge.

Furthermore, for Kinder Morgan's services, Casper customers have a minimum charge such that some small-volume customers pay a minimum fixed charge, while the majority of Casper customers pay only based on the per unit charge multiplied by the volume used. Since there is no fixed customer charge for most Casper customers, it must be that the fixed charge is being collected through the volumetric charge – and as such, large volume users would pay more fixed charges than would small volume users. This is not a rate design necessarily based on cost of service principles. (As an aside, this rate design has not been reviewed for decades!) Yet, the rules would require a strict adherence to this rate design that includes obvious cross-subsidization within the class.

An example from the electric industry is also in order. The cost changes for wholesale power generally involve both changes in demand costs and changes in energy costs with both pieces comprising the total change in the cost of the commodity. Retail utilities, however, may often combine those two cost elements and then simply bill them together as a change in the volumetric, per kWh, rate. Thus, as with the Kinder Morgan example, larger users pay more of the demand cost under this method. This is one way that “equal or proportionate” has been historically implemented. However, there is no guarantee that the rate design will continue to follow the cost-of-service under this method, since the fixed charges are not being separately billed through a distinct rate element.

As an alternative, some distribution electric companies define “equal or proportionate” as ensuring that the same percentage increase applies to each class. This results in different volumetric rates for each class. Even this method would fail, under the Commission’s proposal, since the surcharge, or credit, would not be applied “equally or proportionately to all service schedules and to each of the commodity components of the current rate design.”

Finally, it is the experience of the OCA that the Commission, more often than not, approves rates and not “fundamental rate design relationships.” Thus, this rule would be difficult to implement without a series of new orders and possibly a string of new rate cases for Wyoming’s public utilities. Rate design is as much an art as it is a science. Thus, the kind of precision anticipated by the rule is both unrealistic and unnecessary. The Commission has the discretion to either deny a pass-on if the proposed rate spread is flawed, or to ask the public utility to further justify its proposal. The kind of overall guidance found in the current, as well as the proposed, rule remains useful. However, elaboration of that policy, as contained in the proposed rule, is confusing. Finally, if the public utilities were forced to comply with this mandate, it could require something on the order of full cost of service studies with each pass-on. This could be expensive and time-consuming which would negating the purpose of this expedited and limited regulatory procedure.

The Public Utility Regulatory Policy Act of 1978

On November 9, 1978, the Public Utility Regulatory Policy Act of 1978, also known as PURPA or Public Law 95-617, was signed into law. Section 113 of PURPA indicates that if a state regulatory authority is to adopt standards on *automatic adjustment clauses* (noting that a state is not required to adopt such a standard), such standard must meet the provisions of Section 115(e) of PURPA. Section 115(e) states:

(e) Automatic Adjustment Clauses. –

- (1) An automatic adjustment clause of an electric utility meets the requirements of this sub-section if –
 - (A) such clause is determined, not less often than every four years, by the State regulatory authority (with respect to an electric utility for which it has ratemaking authority) or by the electric utility (in the case of a nonregulated electric utility), after an evidentiary hearing, to provide incentives for efficient use of resources (including incentives for economical purchase and use of fuel and electric energy) by such electric utility, and
 - (B) such clause is reviewed not less often than every two years, in the manner described in paragraph (2), by the State regulatory authority having ratemaking authority with respect to such utility (or by the electric utility in the case of a nonregulated electric utility), to ensure the maximum economies in those operations and purchases which affect the rates to which such clause applies.
- (2) In making a review under subparagraph (B) of paragraph (1) with respect to an electric utility, the reviewing authority shall examine and, if appropriate, cause to be audited the practices of such electric utility relating to costs subject to an automatic adjustment clause, and shall require such reports as may be necessary to carry out such review (including a disclosure of any ownership or corporate relationship between such electric utility and the seller to such utility of fuel, electric energy, or other items).
- (3) As used in this subsection and section 113(b), the term “automatic adjustment clause” means a provision of a rate schedule which provides for increases or decreases (or both), without prior hearing, in rates reflecting increases or decreases (or both) in costs incurred by an electric utility. Such term does not include an interim rate which takes effect subject to a later determination of the appropriate amount of the rates.

The OCA asks the Commission to keep these national policy directives in mind as it goes through this rulemaking process. These are not outdated policies from a no-longer-applicable era. Instead, the pendulum has swung back to an era reminiscent of the time that these policies were enacted. Natural gas was in short supply. Gasoline prices were at record levels. Conservation was being encouraged from the Office of the President to the man on the street. Energy efficiency was important. Energy efficiency and efficiency incentives are still important and should be built into any rules issued

relative to pass-ons and commodity balancing accounts. We also encourage that efficiency examinations and incentives be applied to all types of utilities, not just the electricity industry which is specifically referenced in PURPA. In our suggested modifications to the Commission's proposed rules, we have incorporated some suggested language to introduce the PURPA review concepts.

Purpose and Description of the Commodity Balancing Account

The proposed language for Section 250(a) and (b) should be rewritten to more clearly describe the purpose, nature, and applicability of a Commodity Balancing Account. Much of the proposed language reiterates what is already contained in proposed Section 249. The OCA provides alternative language that distinguishes pass-ons from Commodity Balancing Accounts. The OCA language also removes statements that appear to be an attempt to explain why a public utility may choose to have a Commodity Balancing Account, but are unnecessary. The reason that a utility may wish to have such a regulatory mechanism is more appropriate for an application and/or a Commission order, than a rule.

Similarly, the OCA recommends that the Commission remove the first and second sentences of proposed Section 250(b). These sentences are extraneous commentary that add nothing to the rule and could easily incite debate. Clearly, these sentences would not always be true, and the OCA has publicly taken issue with them in some cases. For example, customers may not be protected if a utility is currently subject to traditional rate case regulation, but is later permitted to move to a cost recovery mechanism that shifts the risk of a significant portion of a public utility's costs to ratepayers without any additional incentives being implemented. A customer may also not be protected if a public utility is allowed to implement a guaranteed cost recovery mechanism without any recognition that its authorized return may need to be reexamined given the utility's reduced risk. In order to avoid these debates, the OCA recommends that these sentences be removed.

Interest on Under and Over-Collections

At the technical conference, the public utilities argued that the Commission's current rule is asymmetrical and, therefore discriminatory. This argument is based upon the fact that the current rule requires the payment of interest on any over collected balance but prohibits the imposition of interest charges on under collected amounts.

This argument ignores the incentives to efficient operation that can be created by the Commission in its rules, policies and practices. For example, without the incentive to accurately estimate future costs of fuel and purchased power that is created by assessing interest on over collections, a utility might design its commodity surcharge to over recover the actual cost of the commodity. The utility would then be free to use the over collected balance to invest in additional plant or short term financial instruments, the proceeds of which would inure to shareholders until such time as the over collected amount was returned to ratepayers through the balancing account. In the absence of a requirement to return the over collection with interest, the utility company would have a perpetual source of short-term, interest free, investment capital. The requirement that utility companies pay interest on over collected balances greatly mitigates a utility's ability to leverage over collections for shareholder gain and aligns the utility's incentives more closely with efficient operating and commodity purchasing practices.

Likewise, authorizing public utility companies to collect interest on under recoveries would give them an incentive to under collect actual commodity costs when the expected return on investment opportunities forgone is less than the interest that could be collected on the under recovered balances. Moreover, the public utility would not be at risk for non-recovery of prudently incurred commodity costs, rather it would merely defer recovery of those costs if it could enhance its return by doing so. This regime would create an untenable arbitrage opportunity whereby public utilities could essentially subsidize shareholder returns at ratepayer expense. The lack of ability to assess interest on under collections aligns the utility's incentives more closely with efficient operating and commodity purchasing practices.

From the perspective of creating the best incentives for efficient utility operations, the current rule, which requires interest to be paid on over collections but prohibits it from being collected on under collections, is perfectly symmetric. Both sides of the equation are focused on giving the utility the best incentive for the efficient and economical operation of its system. Although there have been some exceptions that have allowed one or two public utilities to collect interest on under collected balances under special circumstances, the OCA believes that the best practice is to require interest to be paid on over collections and prohibit interest from being collected on under collections. In fact, in at least one of those cases the Consumer Advocate Staff, which was the OCA's predecessor organization, argued against making such an exception. If however, exceptions are to be made to this rule they should be made on a case-by-case basis and only after an affirmative showing is made by the public utility that such an exception is necessary and in the public interest. We would note that there is currently no exception contained in the Commission's rules, so if the Commission intends to make exceptions to the interest provisions, it should clearly and explicitly define, in its rules, the process by which an exception could be requested and granted.

Other Suggested Changes

The OCA suggests that the Commission change the current references to "utility" to "public utility" throughout the rules. This simply conforms the term to that found in the statutes, such as at W.S. § 37-1-101(a)(iv) where the term public utility is defined. The term public utility is also used throughout W.S. § 37-3-106 which is referenced in the proposed rules.

The OCA has suggested several revisions to the proposed language in Section 249(e). These changes are not intended to change the meaning or nature of the concepts contained in the proposed rules. Rather, our suggestions are meant to try to clarify what the Commission is seeking, and the process involved, regarding support for a public utility's supply and purchase choices.

The OCA also offers alternative language in Section 250(c). This language is simply intended to clarify the concepts and processes proposed in the Commission's draft language. However, we are asking for the Commission to keep its current policy, as contained in the current rules, regarding interest on under collections. As explained above, interest on over collections should be mandated while interest on under collections should be prohibited. To date, only a couple of companies have received authority to impose interest on under collections, and that approval came after a specific showing of unique circumstances.

Regarding the proposed text of Section 250(b), the OCA recommends that the last sentence be eliminated. It is unnecessary for the Commission to indicate that one particular set of records must be maintained and subject to audit. The Commission has general powers that allow it to audit, seek reports, and otherwise investigate matters subject to its jurisdiction. We are concerned that by specifying this one area as being subject to audit someone may try to take issue with the Commission's attempt to audit additional records when this right is not specifically spelled-out in the rule.

Transitional Issues

The OCA requests that the Commission give consideration to transitional issues which will arise when, and if, its present rules are amended. The OCA has consistently stated its belief that, absent a specific waiver provision, the Commission does not have the discretion to waive its rules and regulations. Consequently, the OCA believes that consideration of transitional issues is important.

Clearly, all pass-on applications filed on and after the effective date of the revised rules must be in full compliance with them. However, special consideration may need to be given to pass-on applications pending at the time the rule revisions become effective. The OCA would note that the Wyoming Supreme Court has recognized the applicability of what is known as the "Dillon Doctrine" to the Commission. *U S West*

Communications, Inc., v. Wyoming Pub. Serv. Comm'n, 958 P.2d 376. In essence, this doctrine provides that substantive changes in law will not generally affect actions pending at the time the changes become effective.

Public utilities with Commission approved balancing account tariffs may find these tariffs to be inconsistent with the Commission's revised rules. The timely revision of these tariffs is important. To this end, the OCA suggests that the Commission require public utilities with Commodity Balancing Accounts to amend their tariffs, within a defined time frame, and indicate that filings, under Commodity Balancing Account tariffs, may only be made once they have been revised consistent with the provisions of the amended rules.

Concluding Thoughts

In conclusion, the OCA would remind the Commission that the implementation of commodity cost recovery procedures, such as those contained in Sections 249 and 250 of its rules, is done under the auspices of the Commission's general regulatory authority. There are no specific statutory provisions governing the recovery of commodity and commodity related costs separate from other, non-commodity related costs. Consequently, public utilities operating within the state of Wyoming do not have a statutory right or other claim to a separate, expedited commodity cost recovery procedure. While the OCA is not opposed to the implementation of such procedures, we do believe that they must have appropriate boundaries. In other words, the public interest cannot be served by a free-for-all process by which public utilities are permitted to shift more and more risk from shareholders to ratepayers without an accompanying trade-off. It bears repeating that the statutes which govern the Commission, in the exercise of its regulatory authority, require that rates be just and reasonable.

Respectfully submitted this 27th day of January, 2005.

Bryce J. Freeman, Administrator
Wyoming Office of Consumer Advocate
2515 Warren Avenue, Suite 304
Cheyenne, Wyoming 82002