

1 must be considered in its decisions. I am also here because I am a CEO of a utility that has
2 faced these test-year issues repeatedly in the past and will likely face them again in the future.

3
4 **Q. Will you please elaborate on these concerns?**

5 A. Yes. I have appeared before this Commission numerous times to advocate that the
6 Commission set rates using a test period that best reflects the conditions of the rate-effective
7 period. From 1989 to 2002, Questar Gas was not able to have general rates set at a level that
8 properly reflected its costs in the rate-effective period. Questar Gas could not continue to
9 provide utility customers with adequate utility service and still provide our investors a
10 reasonable return under those conditions. As a result, Questar Gas advocated that the
11 legislature require the use of test-year data that reflect conditions in the rate-effective period
12 in setting just, reasonable, and adequate rates. In the 2003 legislative session, Senate Bill 61
13 was enacted. This bill calls for the use of test period-data that best reflect conditions in the
14 rate-effective period. This was done to provide a mechanism to invoke balance in the
15 regulatory process. Ignoring forecasted data prevents utilities from earning their allowed
16 rates of return. Earning returns sufficient for investors to provide the new capital required to
17 meet the needs of a growing state is not given sufficient consideration. Failure to ensure that
18 test-year data reflects conditions in the rate-effective period thwarts the balance and fairness
19 that is required in setting just, reasonable and adequate rates. What I am seeing in
20 PacifiCorp's current rate case concerns me. The parties opposed to PacifiCorp are proposing
21 a number of seemingly inconsequential adjustments to test-year data. In the aggregate, such
22 proposals slash millions of dollars from the test-year revenue requirement. As a result, the
23 test-year data used to set rates would bear no resemblance to the conditions that will exist in
24 the rate-effective period. Instead of providing independent analysis of the level of revenues,
25 costs, investment and volumes in the rate-effective period, the intervenors simply reject
26 forecasted data and use unfair and confiscatory practices or accounting adjustments as the
27 basis for their test-year adjustments.

28 **Q. What is the purpose of using a test-year in a rate proceeding?**

29 A. The test-year serves as a vehicle to determine just, reasonable, and adequate rates.

1 Decisions regarding the determination of just, reasonable and adequate rates must be based
2 on information best reflective of the conditions that will exist in the future. Historical data
3 unadjusted for known and measurable changes or future data adjusted to match historical
4 data is a poor source of information for future conditions. Rates based on data that does not
5 reflect conditions that will exist in the rate-effective period will not be just, reasonable and
6 adequate. While concerns about the accuracy of forecasted data are valid, concerns about
7 whether historical data or forecasted data adjusted to conform to historical data accurately
8 reflect conditions that will exist in the rate-effective period are just as valid. A properly
9 constructed test-year must reflect future conditions. Relying on historical data is, in fact, a
10 projection that nothing will change in the future, a highly unlikely scenario for a utility faced
11 with increasing numbers of customers and a growing demand for services. Robert L. Hahne
12 summarized this point in his treatise on Accounting for Public Utilities as follows:

13
14 The idea that historic data express factual conditions has sometimes led to the
15 conclusion that those data are the most reliable data available for estimating
16 future conditions. The factual nature of the events as recorded has apparently
17 imbued the data with a degree of soundness and quality that appears to
18 exceed a forecast approach for test year purposes. When conditions are in a
19 state of change, historic data are likely to be the most unreliable in measuring
20 test period conditions as a basis for future rate needs. While projected data,
21 using standard forecasting techniques, may miss the mark, historic data, with
22 a patchwork of updating, will surely miss the mark. As imprecise as
23 forecasting may be, projected test year data based on reasonable forecasts
24 should consistently come closer to expressing future conditions than will
25 historic data as traditionally used.¹
26

27 Mr. Hahne firmly states that projected test-year data based on reasonable forecasts is
28 more reflective of conditions in the rate-effective period than historical data.

29 Either a historical test-year or a future test-year is a forecast of conditions that will
30 occur in the rate-effective period. The Commission must determine that the test-year data,
31 whether it is based on history or forecasts, reflect the conditions in the rate-effective period.

1 Robert L. Hahne, "Accounting for Public Utilities" p. 7-5 (1989).

1 If this is not done, the resulting rates are not likely to be just, reasonable, and adequate.

2
3 **Q. Does Utah law require the Commission to make a determination that the test-year data**
4 **best reflects conditions in the rate-effective period?**

5 A. Yes. Senate Bill 61, was ultimately codified as Utah Code Ann. § 54-4-4(3)(a) and
6 specifically provides that

7 [I]f in the commission's determination of just and reasonable rates the
8 commission uses a test period, the commission shall select a test period
9 that, on the basis of evidence, the commission finds best reflects the
10 conditions that a public utility will encounter during the period when the
11 rates determined by the commission will be in effect.

12
13 The legislature recognized that the state's own budgets including the PSC,
14 DPU and CCS budgets, are not set based solely on historical evidence. They use
15 forecasted data, as do businesses, when setting their budgets.

16
17 **Q. Is Questar Gas's experience incorrectly used in this case to cast doubt on the use of**
18 **projected data?**

19 A. Yes. UAE witness Anderson tries to justify why the Commission should reject
20 PacifiCorp's projected labor costs and uses Questar Gas as an example of why these costs
21 should be reduced. The case to which Mr. Anderson is referring was our 1999 general rate
22 case, where the company was required to use a historical test period. In that case, the
23 Company did receive a rate increase based solely on historical data but it was not reflective
24 of known trends, such as customer growth and declining usage per customer. As a result,
25 rates were set based on test-year data that did not reflect conditions in the rate-effective
26 period. Despite the increase, the Company had no opportunity to earn a reasonable return. In
27 fact, it could not earn a return sufficient to continue to attract the necessary capital to serve its
28 growing customer base unless costs were reduced. Based on its understanding of its
29 customers, Questar Gas had to determine which services were valued most by customers.
30 Services that were not as valued or were valued by only a small portion of customers had to
31 be eliminated. If other cost-cutting measures had been taken, traditional utility services,

1 highly valued by customers, would have been impacted. When a utility's rates are set based
2 on test-year data that does not reflect consideration in the rate-effective period, it has to
3 decide how to manage its costs while meeting its obligations. It comes down to this. What
4 level of service and reliability does the state of Utah desire from its regulated utilities and
5 what price is required to support that level of service and reliability?
6

7 **Q. By the way, was Questar Gas able to earn its allowed return after taking these actions?**

8 A. No. Even with the expense reductions, known conditions in the rate-effective period
9 such as declining usage per customer and increasing numbers of customers resulted in
10 earnings below the allowed levels.
11

12 **Q. What is the end result of continuing to set rates based on costs below levels faced in the**
13 **rate-effective period?**

14 A. Utilities will face a weakened financial position, credit downgrades and difficulty
15 raising the capital necessary to serve customers. Roger A. Morin, author of Regulatory
16 Finance said it best:

17
18 More frequent rate filings, deterioration of financial conditions, down-
19 grading of bonds and difficulty in attracting capital are the inevitable
20 consequences of reliance on antiquated historical data.²
21

22 It is essential that rates set by the Commission use test-year data that are
23 reflective of the conditions in the rate-effective period. Otherwise the resulting rates
24 will not be just, reasonable and adequate.
25
26

² Roger A. Morin, "Regulatory Finance", p. 4 (1994).

1 **Q. You have used the term “just, reasonable and adequate” several times. Does Utah law**
2 **provide guidance on the meaning of this term?**

3 A. Yes. In Sec 54-4a-6(4) providing guidance to the Division it states:

4 For purposes of guiding the activities of the Division of Public Utilities, the
5 phrase "just, reasonable, and adequate" encompasses, but is not limited to the
6 following criteria:

7 (a) maintain the financial integrity of public utilities by assuring a
8 sufficient and fair rate of return;

9 (b) promote efficient management and operation of public utilities;

10 (c) protect the long-range interest of consumers in obtaining
11 continued quality and adequate levels of service at the lowest cost
12 consistent with the other provisions of Subsection (4);

13 (d) provide for fair apportionment of the total cost of service among
14 customer categories and individual customers and prevent undue
15 discrimination in rate relationships;

16 (e) promote stability in rate levels for customers and revenue
17 requirements for utilities from year to year; and

18 (f) protect against wasteful use of public utility services.
19

20 The use of data that are not reflective of the conditions in the rate-effective period
21 does not satisfy these criteria. Specifically the statutory criteria in subsections (a), (b), (c),
22 (e) and (f) are violated. The establishment of just, reasonable and adequate rates requires
23 balancing the six criteria provided in the statute. This balance cannot be achieved if the test-
24 year data do not reflect conditions in the rate-effective period.
25

26 **Q What recommendations do you have for the Commission?**

27 A When considering the intervenor recommendations in this case, the Commission must
28 establish just, reasonable and adequate rates by using test-year data that are reflective of
29 conditions that will exist in the rate-effective period. The following recommendations will
30 aid the Commission: (1) all pertinent and credible data on the levels of revenues, expenses
31 and investment including forecasted data that will impact rates in the rate-effective period
32 should be considered; (2) rates should be based on test-year data that match conditions in the
33 rate-effective period; and (3) the commission should be "directionally correct" and use
34 forecasts for the rate-effective period or adjustments to historical data to reflect expected

1 conditions in the rate-effective period rather than be "exactly wrong" by using historical data
2 or forecasts adjusted to match historical data. Utah utilities need to have a reasonable
3 opportunity to earn their allowed returns by basing rates on data that are most reflective of
4 the conditions the utility will operate in the rate-effective period.

5
6 **Q. What standard should the Commission use in adopting forecasted test-year data?**

7 A. Forecasted test-year data should be adopted if it is consistent with known trends and
8 the conditions the utility will face in the test-effective period.

9
10 **Q. What about concerns that the rates established based on test-year data that reflects
11 conditions in the rate-effective period may be too high or too low?**

12 A. As Mr. Larson has mentioned, the Commission can address these concerns in a
13 couple of ways. The Commission could establish true-up provisions to ensure that utility
14 earnings remain in a reasonable range, or results-of-operations reports could be used to
15 monitor utility earnings. Pass-through or balancing-account procedures are other
16 mechanisms to allow costs to be more fairly included in rates.

17
18 **Q. Do you share PacifiCorp's concerns regarding the unfairness of not using forecasted
19 test-year data?**

20 A. Yes. I share the concerns stated by the PacifiCorp executives. Use of historical data
21 or forecasted data adjusted to reflect historical data, the utility's customers, rate base, costs
22 and volumes are increasing, is purposefully setting rates on data that are not reflective of
23 conditions in the rate-effective period. Rates based on test-year data that are not reflective of
24 conditions in the rate-effective period are not just, reasonable and adequate and violate Utah
25 law.

26
27 **Q. Does this conclude your direct testimony?**

28 A. Yes it does.