OHIO HOUSE ENERGY COMMITTEE

House Bill 142 Proponent Testimony

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Chairman Holmes, Vice Chair Klopfenstein, Ranking Member Glassburn, distinguished members of the Committee, my name is Greg White, and I am testifying today on behalf of Columbia Gas of Ohio in support of HB 142.

I recently retired from my position at the National Association of Regulatory Utility Commissioners, known as NARUC, where I served as Executive Director for more than nine years. All in all, I have been working for more than 40 years in the field of energy and utility regulation, including serving as a Commissioner on the Michigan Public Service Commission, as the Executive Director of the National Regulatory Research Institute (NRRI), and as noted, most recently serving as Executive Director of NARUC.

As I will share in my testimony, the provisions in HB 142 will serve to help improve both the timing and efficiency of natural gas utility rate cases in Ohio, while importantly also maintaining review and procedural protections for consumers. In my view, the combination of these provisions will achieve the desired results and will serve as wins for Ohio. This comes at a critical time as natural gas utilities are being asked to support significant economic growth while maintaining system safety and reliability.

HB 142 Facilitates Economic Growth

As you know, economic growth creating system demand has challenges as the utility must move prudently, but also as expeditiously as possible, to be able to serve the increasing load. Importantly, there are significant system-wide benefits to system growth as well. Foremost among the benefits, a growing system and customer base helps reduce incremental increases to all customers by spreading the system fixed costs among more customers. This has the effect of reducing those costs for all customers.

Further, HB 142 ensures that only the actual plant placed in-service goes into the base rates. The Public Utility Commission of Ohio (PUCO) staff will continue to review the operating and maintenance (O&M) expenses on a forecasted basis. In my view, these provisions represent significant protections for consumers.

Background in Support of HB 142

The landscape for the energy and energy utility industry has been evolving over the last three decades, first with the advent of competition in the 1990's, nowhere more notable than here in Ohio. The pace of this evolution picked up even more in the last decade as rapidly advancing technologies allowed for improvements in safety and efficiency. These technological advancements came at an opportune time as portions of our utility infrastructure needs to be replaced and upgraded. Just in the last few years, the industry has become even more complicated as demand projections have increased dramatically, primarily from economic development projects and system growth by a variety of drivers. Meanwhile, physical security and cyber-security threats have required significant investments in technology and infrastructure to keep up.

As a society, we place significant demands on our energy utilities to provide essential services, and provide them reliably, safely and affordably. This requires utilities to raise capital to support financing the investments necessary, which is easier said than done. There is a great deal of competition in the industry for low-cost financing and investors consider several factors when looking for where to make their investments.

Regulatory Lag

One of the key factors investors consider is "Regulatory Lag" of a utility's rate cases. Regulatory lag essentially refers to the period of delay between the time the utility company files its new rate case and begins to incur its costs, and the time the new rate is approved by the utility commission. The utility typically cannot begin to recover its costs until the rate is approved and goes into effect.

Unfortunately, the time it takes to complete a rate case in Ohio is excessive by any measure. This creates problems both for the utility and for consumers because utilities operating with lengthy regulatory lag tend to realize lower returns on capital and lower credit ratings. Both result in higher costs being passed along to consumers. No one benefits from excessive regulatory lag, which is one of the reasons why I believe HB 142 would create a win-win scenario, where investors have increased confidence, the utility benefits from lower cost of capital and improved cash flow, and customers see the benefits of lower rate increases.

The **key takeaway** here is that as the utility industry evolves to adapt to changing systems, policy, and supply demands, the regulation of the industry too needs to evolve. Good regulation requires rate orders that are timelier to better sync cost recovery with cost incurrence which improves the utility's cash flow. These better support investment, which is particularly important during high investment cycles, such as the one we are witnessing here in Ohio.

Forecasted Test Years

The most common tool for addressing excessive regulatory lag in utility rate cases is to move from using "historical test years" to using "forecasted test years." This approach has been

adopted by a majority of the states in the US. Certainly, Ohio's nearest neighboring states are using forecasted test years in utility rate cases.

The test year essentially serves as the foundation for utility ratemaking. It forms the basis for determining required revenue for a utility to have a reasonable opportunity to recover its costs, while also earning a rate of return sufficient to attract new capital needed to serve customers and maintain a reliable, efficient, safe and secure system.

A historical test year is one that uses data from previous years to estimate the revenue requirements of the utility for future years. While some may take comfort in the use of historical data to estimate future requirements, in fact, utilities in jurisdictions with historical test year rate cases are struggling with financial stresses that threaten their ability to serve their customers well, while also passing along higher rates due to unnecessarily higher costs of capital. In this situation, historical test years can lead to reduced credit quality and chronic under-earning.[1] Historical test years generally assume that costs and revenue remain balanced. This assumption doesn't hold in an inflationary environment with rising costs. In a rising cost environment, rates based on historical test years are un-compensatory even in the year they are implemented.[2] And the current process, with the embedded regulatory lag, basically saddles Ohio utilities with a historical test year even when an Ohio utility proposes a partially forecasted test year.

A forecasted test year, on the other hand, is one that uses data, project planning, and market projections to forecast costs and revenues on a forward-looking basis. A forecasted test year allows utilities to recover costs on a timelier basis, better aligning cost recovery to costs incurred, resulting in improved cash flow and lower costs of capital. The benefits accrue to everyone on the system.

Timely Rate Orders

Along with authorizing the use of Forecasted Test years, HB 142 contains a set of "date certain" provisions that are also important to improving the rate case process by ensuring timely rate orders. Consistently timely rate orders are essential to sending proper signals to investors and the utility of the stability of investments and expected returns. While utilities are generally considered steady investments, the issuance of consistently timely rate orders will serve to reinforce that narrative. The date certain provisions proposed in HB 142 also has the benefit of ensuring that customers do not pay for any investments that are not used and useful to providing safe and reliable utility services.

Savings for Consumers

Further, when compared to the use of a historical test year, timely orders using a Forecasted Test Year allows the utility to more efficiently use its capital. This is accomplished by reducing the post in-service carrying charges, among other things. Based on an analysis of

[1] Pacific Economics Group Research, Forward Test Years for U.S. Electric Utilities, Mark N. Lowry, PhD, et al, prepared for the Edison Electric Institute, August 2010. p.1
[2] Ibid. p.2

deferred expenses associated with several utility riders, Columbia Gas of Ohio would achieve an approximately 5 percent efficiency in its investments, getting more bang for the buck, simply by timing up cash received to the time plant goes in-service. In addition, the utility will likely receive better credit ratings, which means avoiding higher debt costs that would be passed on to customers.

Implementation of Forecasted Test Years and Dates Certain in Michigan

I was actively involved with the passage of the legislation in Michigan in 2008 that first authorized the energy utilities to use forecasted test years in rate cases with dates certain for approving orders by the Public Service Commission. In late 2009, I was appointed to the Commission to serve as a commissioner so then was involved with the implementation of the 2008 law. As you would imagine when introducing changes to a long-standing process, there was some handwringing at the Commission over how well it would work and if the Commission would be able to conduct a proper review. While there was a need for greater coordination at the staff level and in the rate cases to adjust to the timing requirements for the rate orders, once the process was established and put in place, it simply became part of the routine rate case process and did not cause a burden for the Commission staff, or the Commission. Most importantly, the process resulted in approved rates that were deemed to be "just and reasonable."

In responding to survey questions in a study conducted by the National Regulatory Research Institute in October 2013, Michigan offered that the forecasts used in presenting the Forecasted Test Year were a little more complex, "but we would not necessarily characterize this as a problem."[3] At that time of the NRRI study (October 2013), the MPSC had reviewed 20 cases that used a Forecasted Test Year, and the Commission approved each of them. Further, the previously referenced 2013 NRRI study reported that most of the state commissions using forecasted test years expressed confidence in doing so. The study notes "(t)hey have had overall positive experiences, with no thought to discard the use of Forecasted Test Years in subsequent rate cases."[4] Finally, I want to emphasize that most states that participated in the NRRI study reported that using forecasted test years did not take away from or reduce their ability to focus on other topics in the rate cases.[5]

Steps to Improving Rate Case Efficiency Using Forecasted Test Years

There are relatively simple steps that were used in Michigan and in other states that I would deem "best practices" when implementing forecasted test years in rate cases. They are listed below with elaboration on each:

1. Establish a procedural schedule at the outset of the case.

[3] National Regulatory Research Institute, Future Test Year: Evidence from State Utility Commissions, Kenneth Costello, Principal Researcher, Report No. 13-10, October 2013. p.22
[4] Ibid. p.7
[5] Ibid. p.11

a. To ensure that a rate case is conducted in a timely manner, it is critical for a procedural schedule to be established up front, at the outset of the case.
b. Adherence to the established schedule must be maintained and enforced.
c. If adjustments to the schedule need to be made during case, the remaining schedule should be adjusted to maintain the original time requirements of the case to the maximum extent possible.

2. The utility's rate application must set the basis for the case.
    a. Failure to use the utility's rate application will most surely result in an unwieldly schedule that causes undue regulatory lag.

3. Focus field audits and data requests on matters that are material to the rate case.
    a. The rate case should not be an open-ended expedition.
    b. Maintaining materiality to the case ensures the focus is both relevant and significant to the rate case, which in turn ensures the schedule is maintained.

4. Ensure good, professional communication between the Commission staff, the utility, and intervenors.
    a. A key administrative component of a rate case is ensuring a level playing field for case participants. Parties should not be held in the dark about the positions and direction of a case, which requires professional communication.

Summary

In my view, HB 142 contains balanced provisions that will improve the timing and efficiency of the rate cases in Ohio, while maintaining protections for consumers. These provisions are more important than ever given the significantly increasing demand projections in Ohio.

- As the energy utility industry evolves to meet the changing landscape, so too must regulations evolve to support the changing landscape.
- The use of Forecasted Test Years with dates certain for rate orders will better sync cost recovery with cost incurrence thereby creating improved cash flow to support needed investment.
- Consistently timely rate orders send proper signals to investors and utilities about stability of investments and expected returns.
- Growth can help all customers by spreading fixed costs over a wider customer base.
- Timely recovery of investments in natural gas safety and infrastructure is important due to an urgency to upgrade and enhance infrastructure while meeting demand.
- Simple steps, such as establishing a schedule for the rate case at the outset of the case, will help ensure the cases remain timely.

This concludes my prepared testimony. Thank you for providing this opportunity to share my thoughts on HB 142. I would be happy to address any questions you may have.