



BRIEFLY

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Responsible Utility Regulation is a Key Competitiveness Issue

Electricity and telecommunications utilities provide infrastructure critical to the state's economy. These services provide basic support to all of the states businesses. Without them there could be no state economy. As the Washington Competitiveness Council, convened last year by Gov. Gary Locke, stated, "Businesses depend on access to affordable, reliable, state-of-the-art telecommunications services [and] . . . on affordable and reliable energy." Although the Competitiveness Council's recommendations on transportation infrastructure have received the greatest attention, the Council also makes important recommendations with respect to utilities.¹

Almost all of our telecommunications infrastructure and a good deal of our energy infrastructure are provided by private sector businesses. Thus, in contrast to transportation, the Competitiveness Council's recommendations to enhance the business climate in these areas do not require new tax revenues. Rather they require that government act to encourage private sector investments.

The Council has made two critical recommendations for state action regarding utility infrastructure. First, the state should be more accommodating of requests by utilities to site transmission lines and other facilities on state lands. Second, regulators should provide a regulatory climate that will restore the financial health of its investor-owned utilities.

Siting of telecommunications and energy facilities

Telecommunications and energy companies often need to locate facilities along state-owned rights-of-way. The Competitiveness Council reports that state agencies are sometimes slow in responding to company requests for access to rights-of-way and that this can delay important economic development projects. A further problem for utilities is the level of fees that are charged for permits to cross state lands, often higher than necessary to cover the state's cost of permitting.²

In both telecommunications and energy, the old system of monopoly provision is being replaced by competition. Quick response to company requests for access will aid in the timely transition to a new competitive system. The state has a clear interest in managing access to assure that such siting does not compromise safety. It should also manage access in a way that encourages rapid development of competitive communications and energy infrastructure.

A second issue is the price that the state charges for access to its rights-of-way. In many cases the state possesses considerable monopoly power with respect to these assets. The full cost the state charges for right-of-way is certain to be passed through to consumers as an indirect telecommunications tax. Policy



makers should be wary of introducing new cost elements into the emerging competitive telecommunications and energy arenas. Increasing the costs to consumers will dampen investment and inhibit economic development in Washington.

The Competitiveness Council report contains two recommendations. The state “should establish processes that establish firm timelines, clearly stated criteria and fair compensation for the placement of telecommunications infrastructure on” state lands. And the state “should take into consideration the impact the cost of utility infrastructure easements will have on the construction of facilities and the delivery of utility services to energy and telecommunications consumers in the state.”³

Utility Regulation

With our abundant hydropower, low electricity rates have long been a strength of our business climate. However, recent events call into question whether this will continue. REI, Inc. COO Sally Jewell who headed the Competitiveness Council work group on physical infrastructure explains. “Energy prices, specifically low energy prices, have been a competitive advantage of the state of Washington. We have a lot of energy dependent businesses as a result of that. There [are] the obvious players like aluminum. There are emerging players around telecommunications that need a lot of electricity. It is going to be a competitive issue for us if we are to retain those types of businesses.”⁴

Traditionally, the market for electricity has been supplied by public or private monopolies that integrate generation, transmission, and distribution. In recent years this has changed. Federal policy, through the Public Utility Regulatory Policy Act of 1978 and the Energy Policy Act of 1992, has opened up the wholesale market for electricity to competition. A number of states have begun to deregulate their retail markets. The difficulties associated with California’s poorly designed deregulation plan are widely known and have caused many to view deregulation with increased caution.

Washington has not yet moved towards retail deregulation. However, the deregulation of the wholesale market has created major challenges for the state’s investor-owned utilities.

Beginning in late spring 2000, prices in the wholesale market became unprecedentedly high and volatile.⁵ As their costs of purchasing power increased, many government-owned electric utilities in Washington moved quickly to raise their rates. For example, the Snohomish County Public Utility District Board of Commissioners raised rates twice in 2001. Seattle City Light raised rates four times in 2001. And Tacoma Power changed rates twice in less than a year.

In contrast, the Washington Utility and Transportation Commission (WUTC), which regulates private utilities, approving or denying their rate requests, has been slow to process or approve similar price increases for the state’s investor-owned utilities. As a result, credit rating agencies, like Standard and Poors and Moody’s, have downgraded these companies’ bond ratings raising the companies’ costs of capital and reducing their capacity to invest in new plant and equipment.



For example, in July 2001, Avista asked the WUTC for permission to impose for 36.9 percent emergency surcharge on electricity rates. Over the preceding year, Avista had paid substantially more for electricity than it had been able to collect in rates. On September 25 the WUTC granted Avista a temporary 25 percent rate surcharge and ordered the company to file a general rate case by December. Depending upon the information developed in this rate case, the WUTC could order Avista to refund part of this surcharge. A general rate case is a quasi-judicial proceeding, which can take as long as 11 months to complete. The WUTC will ask the utility to carefully document its costs to justify the proposed increase and will hear testimony from other affected parties.

On October 10, Standard and Poor's lowered its corporate credit rating for Avista to BB+ from BBB-. As a result the company is no longer considered to be "investment grade." Further, Standard and Poor's outlook for Avista is negative, indicating that a further downgrading is possible.

In explaining the decision to downgrade Avista, S&P listed steps that the utility has taking to improve its liquidity, but noted that these will only help in the short run and concluded: "Clearly Avista needs a strong show of regulatory support in the form of a rate order that addresses the current cost under-recovery and provides a supportive regulatory framework that addresses the evolving and volatile nature of the electric utility industry." Absent such support, S&P indicated, the utilities credit rating will fall further.⁶

Avista filed a general rate case on December 3. At that time it also requested an interim increase of 10 percent in its base rates. The WUTC may take as long as 11 months to decide the rate case.

In the general rate case the company asks the commission to approve a permanent increase of 22.5 percent in its base rates. Offset by the removal of the interim 10 percent increase and a reduction in the previously approved surcharge, there would be no net increase in rates.

The company also asks that the commission establish a power cost adjustment mechanism that would shift rates up or down with prices that Avista pays for power in the wholesale market.

Similarly, in August, Puget Sound Energy applied to the WUTC for interim rate relief. Under that proposal, Puget would track the difference between certain of Puget's actual power costs and the corresponding costs embedded in the utilities rates. To the extent that the actual cost exceeded the embedded, Puget would be allowed to recover the excess through a surcharge on customer bills. (And if actual cost fell short of the embedded, the difference would be refunded to customers.)

On October 4, the commission rejected Puget's request for interim relief, holding that the utility had not demonstrated that "failure to grant the requested relief would cause clear jeopardy to the utility." But the commission invited the company to proceed with a general rate case.

On October 8, Standard and Poor's downgraded Puget as a result of the rejection. Standard and Poor's analyst wrote, "By exhibiting a lack of financial urgency in rejecting Puget Sound's proposal, Standard & Poor's is concerned about the WUTC's regard for the severity of the situation, as well as Puget Sound's credit quality."⁷ On October 9 Moody's also downgraded Puget.



Puget next petitioned the commission to reconsider its rejection of the request for interim relief, citing the downgrades by Standard and Poor's and Moody's. On October 24 the commission reaffirmed its rejection.

Finally, on October 30, Standard and Poor's lowered the its corporate credit rating on Puget from BBB to BBB-, only one step above a "speculative" rating. The announcement explained:

"Puget Sound Energy's financial position is hampered by the Washington Utilities and Transportation Commission's (WUTC) recent rejection of a motion for reconsideration of its October 2001 decision that denied interim rate relief . . . The company's inability to fully recover these costs in a timely fashion continues to severely pressure the company's strained credit-protection measures. . . . The company's historically above-average business profile is eroding as the result of a slowing economy and lagging responsiveness by regulators. Also of concern are the company's increasing power needs over the next several years, rising purchased-power costs, and the absence of a periodic rate adjustment mechanism."⁸

On November 26, Puget Sound Energy filed a request for a general rate increase with the WUTC. Under the request, electricity rates would increase by 16.5 percent. (Customers would see an increase of 14.5 percent when the benefits of Puget's new contract with the Bonneville Power Administration are netted in.)

Puget proposes that customers be provided with an "adjustable rate option." Those electricity customers who chose this option would face rates that varied daily depending on the costs of electricity in the wholesale market. This builds upon the utility's current pilot Personal Energy Management program, which varies the rates charged to customers by time of day.

To the extent that consumers take advantage of this option, it will provide two benefits. First, consumers' incentive to conserve will increase in times of scarcity, leading to a more efficient utilization of electricity. And second, Puget's revenues will be tied more directly to its costs, which would support a higher credit rating. As noted above, one of Standard and Poor's concerns regarding Puget was the lack of a rate adjustment mechanism.

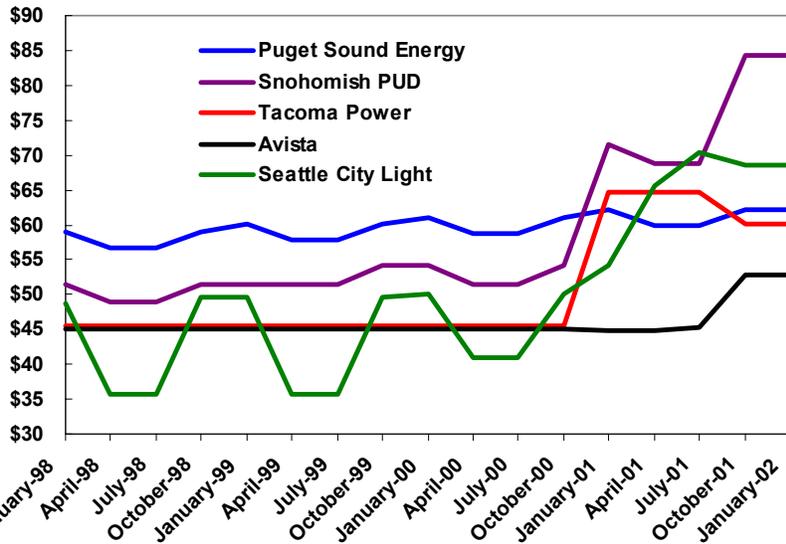
Against the background of the Avista and Puget cases, Sally Jewell observed, "From a business standpoint the utilities need to know that as the cost of things outside their control, like natural gas or stream flows or so on, go up, that they can over time recoup those expenses as opposed to going out of business."⁹ The Competitiveness Council recommended that Gov. Locke "act to assist in restoring the financial health of the state's utilities and to ensure that the political and regulatory climate in Washington is supportive of its utilities."¹⁰

The Competitiveness Council urged the WUTC to help protect the companies' financial health: "Recognizing the changing dynamic of wholesale electricity markets and the impact it may have upon the financial resources of investor-owned utilities, regulators should endeavor to respond as quickly as possible to requests for rate approvals and to [allow] as much rate flexibility as may be necessary to enable utilities to provide reliable and cost-effective service."¹¹

Chart 1 shows the monthly electricity cost for a 1000 kilowatt-hour residential customer for Seattle City Light, Tacoma Power, Snohomish County PUD, Avista and Puget Sound Energy. The government-owned utilities were



CHART 1
Residential Electric Rates
1000 kwh/month



Source: WUTC

able to quickly pass along their increased costs in the wholesale market to their customers.

Discussion

Insuring that the state has modern and capacious energy and telecommunications infrastructure is a critical part of a competitive state economy. Much of this infrastructure is built, operated, and maintained by private businesses regulated by the state. These businesses are buying and selling in rapidly changing and increasingly competitive markets. The state should adjust its view of its regulatory role. It should support and encourage these businesses and facilitate their ability to attract investment capital by acting more quickly and positively. Most important, state regulators must

understand and appreciate the dampening effects on the state's economic vitality of their current attitude toward private utilities. These regulators have a key role to play in assuring that Washington makes the infrastructure investments necessary to support our state's continued economic health.

(Endnotes)

- ¹ Washington Competitiveness Council, *Draft Final Report*, December 2001.
- ² The Research Council's report on telecommunications deregulation discussed the importance of fair access to public rights-of-way.
- ³ Washington Competitiveness Council, *Draft Final Report*, December 2001, p. 35.
- ⁴ Washington Competitiveness Council December 11 meeting.
- ⁵ 2001 Biennial Energy Report, p. 1-31.
- ⁶ Standard and Poor's, *Utilities and Perspectives*, October 15, 2001, p.9.
- ⁷ Standard and Poor's, *Puget Sound Energy Inc. and Subs Rtgs On CreditWatch Neg After Proposal Rejection*, Oct. 8, 2001.
- ⁸ Standard and Poor's, *Puget Sound Energy Ratings Lowered, Off Watch; Outlook Negative*, Oct.30, 2001.
- ⁹ Washington Competitiveness Council November 13 meeting.
- ¹⁰ Washington Competitiveness Council, *Draft Final Report*, December 2001, p. 36.
- ¹¹ Washington Competitiveness Council, *Draft Final Report*, December 2001, p. 35.

