Q. McShane Evidence – Please confirm that the forecast test year is the least risky test year for a utility and rank the riskiness of other types of test years in comparison to the forecast test year and please explain the circumstances under which the differences among test year types may impact upon a utility's ability to earn its allowed rate of return.

A. All other things equal, a forecast test year would be viewed as the least risky, followed by a partially forecast test year, a historic test year with known and measurable changes and a historic test year.

The extent to which a particular type of test year impacts a utility's ability to earn its allowed rate of return depends on a number of factors, including: the rate of growth in customers and load, the rate of inflation, the room a utility has for productivity gains, the amount of capital that a utility is required to add, as well as the existence of adjustment mechanisms. For example, although the state of Alabama has traditionally used historic test years to set base rates, Alabama Power, a subsidiary of Southern Company, is regulated using a Rate Stabilization and Equalization Factor, which updates the company's rates on a forward looking basis so as to permit the utility to earn a return on equity within its allowable range. Similarly, in South Carolina, where Piedmont Natural Gas operates, the test year is typically historical, but Piedmont operates with a Rate Stabilization Tariff which resets rates to allow the utility to earn its allowed ROE. In these cases, the type of test year is effectively moot.