BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of a Working Case to Consider Policies to Improve Electric Utility Regulation	)))	Case No. EW-2016-0313

INITIAL COMMENTS OF
THE MIDWEST ENERGY CONSUMERS' GROUP

COMES NOW, the Midwest Energy Consumers' Group ("MECG") and for its Initial Comments in the above captioned docket, respectfully state as follows:

1. On June 8, 2016, the Commission issued its *Order Opening a Working Case to Consider Policies to Improve Electric Utility Regulation*. Despite the broad nature of this title, the Commission's order provides very little guidance regarding the nature of the comments that it is seeking. Rather, the Commission's Order simply stated that "the Commission will invite interested stakeholders to submit written suggestions for policy changes by July 8, 2016."

2. Subsequently, on June 22, 2016, Chairman Hall provided an extensive write up of proposed legislation. Despite the extensive nature of this proposed legislation, the Commission did not extend the filing deadlines. As such, the Commission provided barely two weeks for parties to review the proposed legislation, understand that legislation and prepare comments. As the Commission is undoubtedly aware from the recent legislative session, two weeks is not adequate time to provide meaningful comments on the Chairman's extensive proposed legislation.

3. The expedited period was further undermined by the fact that parties were not provided notice of the Chairman's subsequent filing. Specifically, while the initial order was served on parties, the Chairman's *Notice of Policy Initiatives* was not served on

any parties. Furthermore, because this is a workshop docket with no actual parties, the Commission's Electronic Filing System ("EFIS") did not provide notice to parties of the Chairman's filing. Therefore, unless parties were continually searching EFIS for further filings, they were not aware of the Chairman's filing. As such, the minimal two weeks that were provided to digest the Chairman's proposed legislation was further reduced. While the utilities are undoubtedly able to muster the resources to comment in such a short period of time, customers lack those same resources.[1] Given this, MECG is worried that the Commission will attempt to make critical decisions regarding legislative changes based upon comments that are decidedly one-sided. Ultimately, given the inadequate opportunity to prepare comments, MECG has not prepared any specific comments on the Chairman's proposed legislation. Rather, MECG will use the brief time available to prepare comments of a more overarching nature.

4. Repeatedly throughout the recent legislative session one heard the comment that the utility legislation was a "solution in search of a problem." Specifically, the utilities and the sponsors of the legislation failed to articulate either the inadequacies of the current legislative paradigm or the problems that result from these shortcomings. Instead, given their infatuation with a process that eliminates the customers and neuters the Commission, the utilities and the sponsors simply relied on rhetoric that focused on the dated nature of the Public Service Commission Act. The clear strategy was to imply that a statute that is 100 years old must necessarily be deficient. Ultimately, the utilities'

[1] Customer's opportunity to draft more thorough comments was also undermined by the sudden filing of rate cases by Ameren and KCPL on the same date. Given the Commission's policy to set early intervention deadlines, counsel was compelled to turn his attention to these rate cases instead of preparing comments in this docket.

failure to articulate the nature of the problem to be solved was one of the principal reasons that the legislation failed to progress out of either the House or the Senate.

5. Now, the Commission's inquiry suffers from the same shortcomings. Specifically, the Commission's *Order* as well as the Chairman's *Notice of Policy Initiatives* both fail to alert customers of the specific problems that need to be addressed. The *Notice of Policy Initiatives* focuses on numerous topics (regulatory lag, investment, etc.), but fails to either identify a problem or state why the author believes a problem actually exists. Given this failure, customers are left to believe that at least some have bought into the utilities' constant whining about the current system without an iota of critical thought as to whether a problem actually exists or whether this whining is really a utility strategy designed to improve the system to the shareholders' advantage. For this reason, the draft legislation, like the utility legislation that preceded it, is truly "a solution in search of a problem."

6. As these comments indicate, however, overarching metrics indicate that the Commission, as well as the General Assembly, should be hesitant to engage in broad-brush changes to the ratemaking mechanism. Specifically, the current paradigm: (1) encourages cost minimization; (2) results in strong Missouri utilities; and (3) provides for reliable service. All of these goals are achieved at rates that are largely competitive with national average electric rates. Given the strengths of the current system, the Commission and the General Assembly should be reticent to make changes absent a clear articulation of the problem to be solved.

I. ENCOURAGES COST MINIMIZATION

It goes without question that companies operating in a competitive environment feel daily pressures to minimize costs. While certain costs are bound to increase, competitive companies cannot simply increase the cost of their product or service. Recognizing the constant threat of other companies taking their customers, competitive companies must instead look to minimize other costs prior to increasing the cost of their product. In this way, a competitive environment demands that participants minimize their costs or fail.

On the other hand, utilities operating in a monopoly environment do not face the same competitive pressures or need to minimize costs. Absent price regulation, monopoly utilities would be completely ambivalent to cost levels. Rather, these utilities would continually increase rates in response to increasing costs without any consideration of their ability to minimize other costs. Left to the utility's inability / unwillingness to control costs, electric rates would skyrocket. For this reason, fearful of utility's inability to control costs or rates, states have implemented rate regulation.

Under regulation, utilities can no longer unilaterally increase rates. Instead, utilities must apply to the state utility commission for approval of their rate increases. Given the time necessary for the commission to consider and approve the utility's rate increase request, there is always some lag between when the utility begins to realize an increasing cost and when that cost can be reflected in rates. While utilities constantly bemoan this lag and propose adjustment clauses and trackers to eliminate this lag, this "regulatory lag" provides a competitive surrogate that requires the utility to seek to minimize costs. In this regard, the longer the regulatory lag, the greater the pressure for

the utility to minimize costs. Similarly, the shorter the regulatory lag, the lesser the pressure for the utility to minimize costs.

As a former Missouri Commission Staff auditor notes, regulatory lag operates as "an efficiency incentive." Specifically, regulatory lag "financially rewards the utility for achieved cost reductions, by allowing it to keep those savings until the next case, and punishes the utility, through reduced earnings, when costs increase more rapidly than revenues between test years."[2]

The beneficial nature of regulatory lag as an "efficiency incentive" is well established. As this Commission noted in a recent Ameren rate case:

> Regulatory lag results because a rate case test year, at least in Missouri, is based on a historical test year, usually ending about the time the utility files for a rate increase. Since a rate case takes eleven months to complete, a utility will always be about eleven months behind. Of course, utilities do not particularly like regulatory lag when their costs are increasing, but regulatory lag can also favor the utility when their costs are decreasing. ***<u>The good effect of regulatory lag is that it provides the utility with a strong incentive to maximize its income and minimize its costs</u>***.[3]

Recognizing that regulatory lag is the primary mechanism that requires the utility to seek to minimize costs, it stands to reason that Commission efforts to reduce regulatory lag will reduce the pressure to minimize costs and result in rates increasing higher than they would be otherwise. For this reason, MECG urges the Commission to be very cautious in implementing mechanisms or processes which reduce regulatory lag.

That said, to the extent that regulatory lag is reduced it should be done in an <u>impartial</u> manner. Importantly, the burden associated with shortening a rate case should not be borne entirely by customers. Rather, any burden associated with processing a rate

[2] Brosch Direct, Case No. ER-2014-0370, page 13.
[3] *Report and Order*, Case No. ER-2007-0002, issued May 22, 2007, at page 18.

case in a shorter period should be done in a manner that is equally burdensome to all stakeholders: utility, customers and the Commission.

In a previous workshop, the Commission considered ratemaking changes to reduce regulatory lag.[4] There, while the Commission considered shortening rate cases, it considered other changes designed to ensure that a shorter rate case was not done solely at the expense of the consumers and to the benefit of the utility. Specific changes included a requirement that the utility provide responses to numerous standard data requests with the filing of its rate case. Other changes included more expansive minimum filing requirements as well as a shorter response time for data requests. Finally, the report recognized that a shorter rate case may not accommodate a true-up that was extended as far beyond the test year. Thus, there was an additional burden to the utility associated with the shorter rate case.

Of equal importance, the burden of the shorter rate case was also partially imposed on the Commission. Unlike today, where the Commission only meets once a week, that Commission would hold multiple meetings in a week to deliberate and efficiently decide rate cases.[5] In this way, the Commission had less time to deliberate a rate case <u>and</u> the regulatory law judge had less time to write a Report and Order. Bottom line, all stakeholders shared the burden of a shorter rate case.

Such a reasoned process stands in stark contrast to that utilized in the pending GMO rate case. There, despite a proposed 11-month procedural schedule and without any request from the utility, the Commission unilaterally reduced the procedural schedule

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[4] Final Report issued July 8, 2004.

[5] Not long ago, consistent with its statutory mandate to "devote their entire time to the duties of their office" (Section 386.120.2), the Commission would meet for a public meeting every day of the week. Certainly such regular meeting could better accommodate a short rate case.

to 10 months. Since the case was already filed, the shorter rate case could not accommodate other procedural safeguards such as a requirement that GMO include responses to standard data requests with its rate case filing.[6] Additionally, GMO was not required to accept a shorter true-up time. As such, utilities were left to reap the entire benefit of the shorter case and customers were left to bear the entire burden.

Even after the parties to the case proposed a procedural schedule that would process this case within the desired ten months, the Commission then rejected the schedule and began to move dates without any consultation with the parties. These changes were made solely to allow the Commission the same amount of time to deliberate the rate case.[7] Rather than consider more deliberations, the Commission maintained its one meeting per week and insisted on the same amount of time to process a decision. Thus, not only did the utility not suffer any of the burden associated with the shorter rate case, the Commission / Administrative Law Judge also did not absorb any of the burden. Only consumers were left to suffer. Bottom line, the Commission's efforts in the recent GMO rate case were completely devoid of the reasoned approach considered by previous Commissions. The ultimate effect of this unreasoned approach was to process a rate case in a month less time all at the expense of the ratepayers.

From this section, MECG hopes that the Commission comes to three conclusions. First, regulatory lag is a necessary aspect of the rate case process. Second, regulatory lag is the primary means by which the regulator replicates the competitive pressure to

[6] Interestingly, GMO's sister company (KCPL) filed another rate case on July 1. There, KCPL proposed a ten month procedural schedule, but again failed to recognize any of the procedural safeguards for the benefit of ratepayers. Specifically, KCPL did not provide any responses to standard data requests with its filing. Furthermore, KCPL did not propose to reduce the true-up period. Instead, KCPL, like GMO before it, seeks to impose the entire burden for the shorter rate case on the customers.

[7] Specifically, despite having one month less to complete its consideration of the utility's proposed tariffs, the Commission kept the same 29 days that it was provided under a full 11-month procedural schedule.

minimize costs. Third, any efforts to reduce regulatory lag must be made in a reasoned manner such that the burden is shared by the utility and Commission in addition to the customers.

II. STRONG MISSOURI UTILITIES

It is undisputed that the current regulatory paradigm in Missouri has led to financially strong Missouri utilities. The financial strength of Missouri electric utilities is evidenced by: (1) S&P credit ratings; (2) the increase in stock prices over five years; (3) merger and acquisition ("M&A") activities and (4) third-party assessments of Missouri regulation.

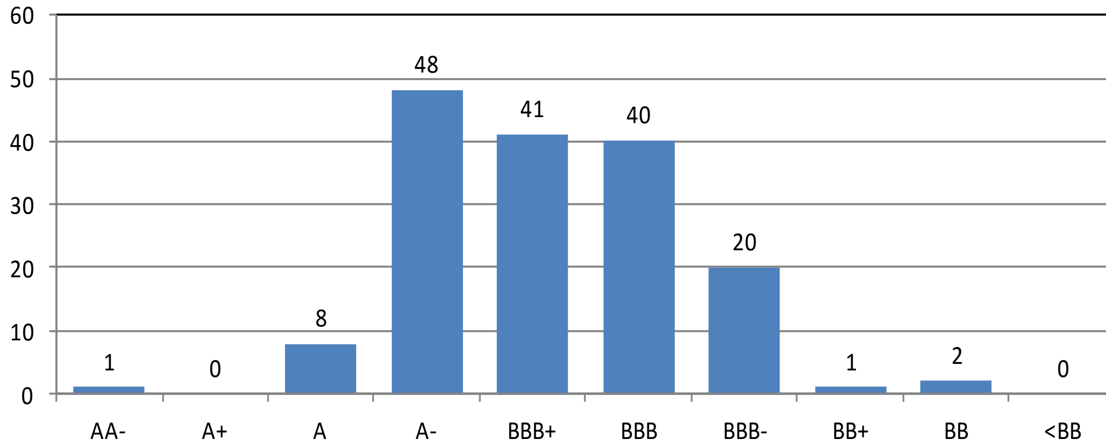
A. CREDIT RATINGS

The financial strength of Missouri utilities is reflected in the investment grade credit ratings assigned by Standard & Poors. Specifically, Missouri electric utilities carry credit ratings that place them solidly among utilities operating in Missouri and neighboring states.

Utility	Parent Company	Neighboring Jurisdiction	Rating
MidAmerican	Berkshire Hathaway	Iowa	A
Interstate Power & Light	Alliant	Iowa	A-
Duke Energy Kentucky	Duke Energy	Kentucky	A-
Kentucky Utilities	PPL	Kentucky	A-
Louisville Gas & Electric	PPL	Kentucky	A-
Oklahoma Gas & Electric	OGE Energy	Arkansas / Oklahoma	A-
Ameren Missouri	Ameren	Missouri	BBB+
Kansas City Power & Light	Great Plains Energy	Missouri / Kansas	BBB+
KCP&L Greater Missouri Operations	Great Plains Energy	Missouri	BBB+
Ameren Illinois	Ameren	Illinois	BBB+
Kansas Gas & Electric	Westar	Kansas	BBB+
Southwestern Electric Power	AEP	Oklahoma	BBB
Empire District Electric	None	Missouri / Kansas / Oklahoma / Arkansas	BBB
Commonwealth Edison	Exelon	Illinois	BBB
Appalachian Power	AEP	Tennessee	BBB
Kentucky Power	AEP	Kentucky	BBB
Entergy Arkansas	Entergy	Arkansas	BBB
Public Service Company of Oklahoma	AEP	Oklahoma	BBB

On a broader basis, the credit rating of Missouri's electric utilities is also seen when compared against nationwide utilities. Here, Ameren and Great Plains Energy with

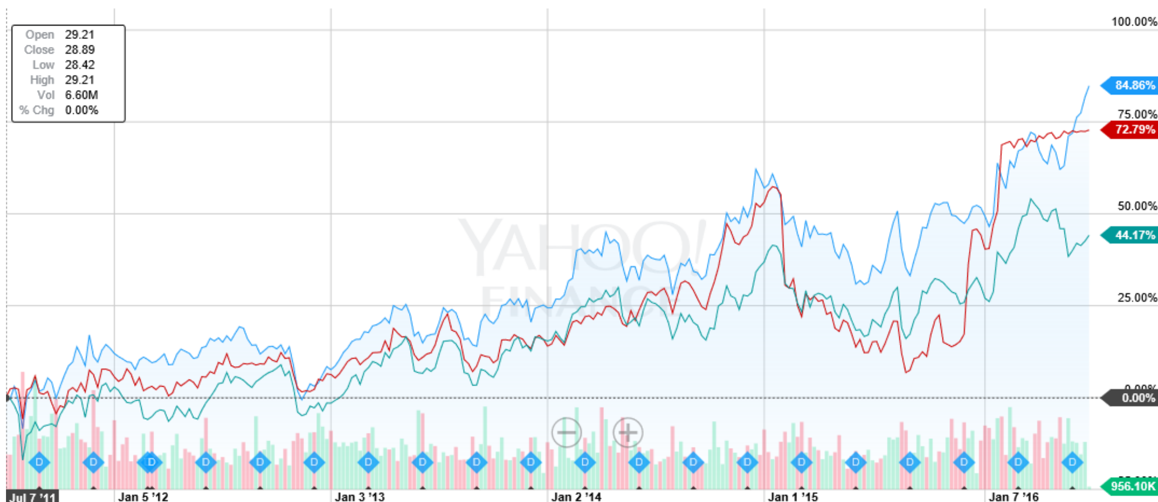
a BBB+ and Empire with a BBB rating are solidly positioned against other national electric utilities.



In fact, Ameren and KCPL enjoy a credit rating 65% higher than that of the investor-owned electric utilities ratings by Standard & Poors.

B. <u>STOCK PRICES</u>

Missouri utilities have not only benefitted from strong credit ratings, the shareholders of those utilities have also benefitted from a rapid increase in stock prices. As the following chart demonstrates, over the past five years, shareholders of Missouri utilities have seen stock prices increases that have outpaced the Dow Jones industrial average. Specifically, while the DJIA has increased by 43.18%, the Great Plains stock price (green) has increased by 44.17%; the Ameren stock price (red) has increased by 72.79%; and the Empire stock price (dark blue) has increased by 84.86%. In fact, both Ameren and Empire's stock prices also exceed the Dow Jones Utility average (64.31%) over the same period of time.



C. <u>MERGER & ACQUISITION ACTIVITY</u>

The supportive nature of Missouri regulation has also been demonstrated by merger and acquisition activity. Over the past 20 years, Missouri utilities have relied upon the cash flows provided to finance the acquisition of other utilities.

► <u>Union Electric</u>: In 1996, Union Electric acquired Central Illinois Public Service Company ("CIPSCO") and formed Ameren. In 2003, Ameren acquired Central Illinois Light Company ("CILCO"). In 2004, Ameren acquired Illinois Power ("IP"). As a result of the cash provided by Missouri operations and the stability of Missouri regulation, Ameren has been able to grow revenues by almost 50% through the acquisition of the Illinois companies.

► <u>Kansas City Power & Light</u>: In 2007, Great Plains Energy (parent company of KCPL) acquired the Missouri operations of Aquila, Inc. More recently, on May 31, 2016, Great Plains Energy announced that it was acquiring Westar Energy, the largest electric utility in Kansas. Again, as a result of cash provided entirely by Missouri

operations and the stability of Missouri regulation, Great Plains has been able to acquire other utilities and grow the size of the company.

► Empire District Electric Company: Given its size[8], Empire is unable to acquire other electric utilities. Despite its size, Empire is still able to demonstrate the attractiveness of Missouri regulation. Specifically, on February 9, 2016, Algonquin Power & Utilities Corp. announced that it was acquiring Empire. The attractiveness of Missouri regulation is demonstrated by the fact that Algonquin agreed to pay a 50.1%% premium over the Empire stock price on December 10, 2015 when Empire announced that it had received an offer and was exploring a sale of the company.[9] Certainly, one would not expect a sophisticated utility to agree to buy Empire for such a large premium if Missouri regulation was detrimental to shareholder interests.[10]

The supportive nature of Missouri regulation is not only demonstrated through the M&A activities of its electric utilities. Supportive Missouri regulation has also provided the platform for gas and telephone utilities to grow into multi-jurisdictional national utilities.

► Laclede Gas Company: In 2013, Laclede Gas purchased Missouri Gas Energy. In 2014, Laclede purchased Alabama Gas Corporation ("Alagasco"). On April 26, 2016, Spire, Inc. (the newly named parent company of Laclede) announced that it was acquiring EnergySouth, the parent company of Mobile Gas and Willmut Gas.

► Southwestern Bell Telephone: In 1984, at the time of the AT&T divestiture, Southwestern Bell ("SWBT") was a regional bell operating company ("RBOC")

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[8] By virtually any measure (revenues, market capitalization, etc.), Empire is among the smallest regulated electric utilities in the United States.

[9] Empire was trading at $22.65 on December 10, 2015. Algonquin agreed to purchase Empire for $34.00.

[10] It is important to recognize as well that Algonquin has agreed not to seek to recover any of this premium (acquisition adjustment) from ratepayers.

headquartered in St. Louis. Shortly thereafter, SWBT set out on a strategy of acquisitions, built largely on Missouri customers and regulation. Now known again as AT&T, it is one of the largest companies in the United States.

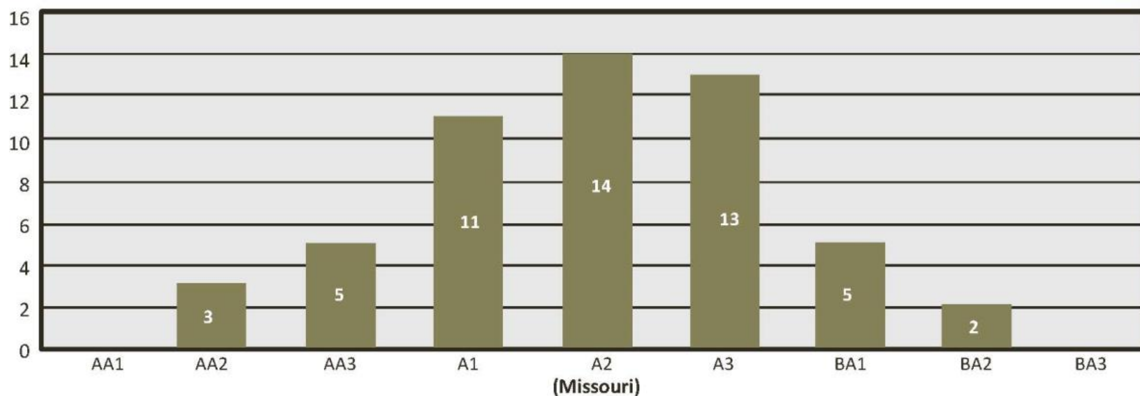
In 1996, SBC (SWBT parent company) acquired Pacific Telesis (regional bell operating company in California and Nevada. In 1998, SBC acquired Southern New England Telephone Company. In 1999, SBC acquired Ameritech (regional bell operating company in Illinois, Indiana, Ohio, Wisconsin and Michigan. In 1999, SBC acquired Comcast Cellular. In 2005, SBC acquired its former parent company AT&T and adopted the AT&T name. In 2006, SBC acquired BellSouth, the regional bell operating company in 14 southeastern states. This also allowed for the completed ownership of AT&T wireless. Today, AT&T is the 23rd largest company in the world.

Clearly, while Missouri utilities have consistently bemoaned the nature of Missouri regulation, that regulation has provided a springboard for these companies to grow into some of the largest utilities in the United States. Certainly, acquisitions such as those discussed above are not reflective of a regulatory system that is detrimental to shareholders.

D. THIRD PARTY REGULATORY ASSESSMENTS

The supportive nature of Missouri's regulation is also prevalent in third-party assessments of state utility commissions. For instance, on May 31, 2016, Standard & Poors issued a statement regarding Great Plains Energy credit rating in response to the announcement that it was acquiring Westar Energy. In that statement, S&P referenced a "generally constructive regulatory framework."

The supportive nature of Missouri regulation is also found in assessments from Regulatory Research Associates ("RRA"), an independent research firm specializing in utility securities and regulation. In their assessment of state utility commissions, RRA assigned Missouri regulation an A2 rating. As shown, this places Missouri solidly among other state utility commissions. Clearly, given this A2 rating, the Missouri commission is fulfilling its duty to balance the interests of utility shareholders and customers.



III. <u>RELIABLE CUSTOMER SERVICE</u>

While Missouri regulation has been very supportive of utility shareholders, it has been careful to ensure that utility service has not suffered. The reliable nature of Missouri electric service is reflected in JD Power surveys.

On January 13, 2016, JD Power issued its most recent <u>Electric Utility Business Customer Satisfaction</u> survey. As the study specifically notes, the number one factor in customer satisfaction is "power quality and reliability." In that study, Ameren Missouri, with a score of 723, rated #1 among large utilities in the Midwest Region. Interestingly, KCP&L came in a close second with a score of 722. The 2016 survey demonstrates significant improvement in reliability for these Missouri utilities. Specifically, Ameren Missouri's reliability score has increased 12.3% since 2013 when it had a score of 644.

Similarly, KCPL's score has increased 12.1% over the same time when it also had a score of 644.

IV. COMPARABLE RATES

Missouri's supportive regulatory environment has not come at the expense of competitive electric rates. While Missouri's rates have escalated quickly over the last 10 years, the overall Missouri electric rate remains competitive with other states. According to the federal government's Energy Information Administration, Missouri's electric rates rank 18th in the nation. In fact, Missouri's average rate of 9.11 cents / kWh is 13% below the national average rate.

Year	State	Year	State	Year	State
Washington	7.13	Virginia	9.17	Wisconsin	10.57
West Vitginia	7.65	Alabama	9.27	Florida	10.77
Wyoming	7.76	North Carolina	9.33	Michigan	11.03
Arkansas	7.90	Illinois	9.36	Delaware	11.22
Idaho	7.93	Tennessee	9.40	Maryland	12.10
Louisiana	8.09	Minnesota	9.52	District of Columbia	12.11
Iowa	8.15	Mississippi	9.60	Maine	12.65
Kentucky	8.15	New Mexico	9.65	New Jersey	13.95
Oklahoma	8.18	South Carolina	9.67	Vermont	14.57
Utah	8.35	Nevada	9.73	California	15.15
North Dakota	8.41	Ohio	9.73	New Hampshire	15.22
Montana	8.59	Georgia	10.03	Massachusetts	15.35
Oregon	8.68	Colorado	10.06	Rhode Island	15.41
Nebraska	8.84	Kansas	10.16	New York	16.25
Texas	8.94	Arizona	10.18	Connecticut	17.05
South Dakota	9.05	Pennsylvania	10.28	Alaska	17.46
Indiana	9.06	U. S. Total	10.44	Hawaii	33.43
Missouri	**9.11**				

V. CONCLUSION

As the preceding analysis demonstrates, it is difficult to identify, from the overarching metrics, that there is a problem with Missouri regulation. Specifically, the

Missouri regulatory process properly relies on regulatory lag in order to minimize costs. While regulatory lag may be detrimental to the utility, the metrics indicate that utility shareholders are still benefitting in the form of high investment grade credit ratings and rapidly escalating stock prices. Missouri utilities have used the supportive Missouri regulatory climate as a platform to acquire other utilities and become multi-jurisdictional utilities that are among the largest in the country. While shareholders have benefitted greatly from this regulatory climate, ratepayers have still seen reliable electric service at competitive rates.

Given the absence of any metric demonstrating a problem with the Missouri regulatory process, MECG struggles to make suggestions as to overarching changes to the Public Service Commission's legislative authority.

Respectfully submitted,

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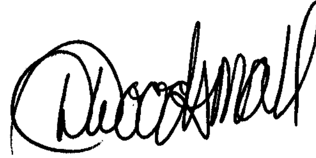
CERTIFICATE OF SERVICE

I HEREBY CERTIFY that I have this day served the foregoing pleading by email, facsimile or First Class United States Mail to all parties by their attorneys of record as provided by the Secretary of the Commission.



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David L. Woodsmall

Dated: July 11, 2016