



July 8, 2016

Re: Missouri Energy Development Association (MEDA) Comments—Missouri Public Service Commission (MoPSC) Working Case to Consider Policies to Improve Electric Utility Regulation (EW-2016-0313)

On behalf of MEDA and its electric members, I would like to thank Chairman Hall and the Commission for their initiative to consider alternatives to the current regulatory practices. MEDA has considered and sponsored legislation in the past with the objective of making the process more efficient, reflective of actual costs, and reducing overall costs for all parties. MEDA continues to be invested in this effort and will be a full participant in the working case.

We also appreciate the Chairman's proposal to change the regulatory framework that was introduced this past legislative session, as it provides a positive platform around reform. Some aspects of the proposal, along with other potential changes, could be helpful moving forward. Specifically, in reviewing the regulatory timelines outlined in the proposal vs the status quo, we do not feel that it will improve the current regulatory lag situation. That being said, we look forward to discussing this approach and other stakeholder ideas in the months to come.

Our Members, Our Focus

Organized in 2003, MEDA is the association of Missouri's Investor-Owned Utilities and their strategic partners. Our members serve nearly 4 million customers, invest over \$1 billion in-state annually, and employ over 11,500 Missourians while providing the electric, natural gas, and water services integral to the safety and prosperity of all Missourians.

Our mission is to work closely with Missouri Investor-Owned Utilities and their strategic partners, representing their interests and advocating balanced policies in legislative and regulatory arenas. MEDA provides credible public policy leadership, pivotal industry awareness and education, and strategic business intelligence.

MEDA is filing on behalf of the following primary Investor-Owned member businesses that are the focus of this working case: Ameren Missouri, The Empire District Electric Company, and KCP&L (inclusive of KCP&L Greater Missouri Operations Company).

General Comments

The long-standing concept known as the "Regulatory Compact" recognizes a set of mutual rights, obligations, and benefits forming, in effect, a relational contract between utilities and their customers. Under the concept, the utility is granted an exclusive service franchise/territory, and in exchange, accepts the responsibility to serve everyone in the territory and submit to price (rate) regulation. The utility is obligated to supply service efficiently, but has the right to recover its costs, including an opportunity to earn a return/profit equal to its market-determined cost of debt and equity capital. (McDermott, 2012)

“Beginning in the 1970s and continuing through the present time, economic, technical, and financial factors have threatened to disrupt the fundamental balance of the Compact. Chief among these has been the loss of sales growth, which traditionally provided revenues to help fund new construction, and offset other rising costs between rate cases.” (McDermott, 2012)

“In fact, electric consumption grew at less than 0.5% during 2000-2010. Natural gas consumption stagnated back in the 1970s and had no growth during 2000-2010. Public supply water consumption per capita declined from 1990-2005.” (The Brattle Group and NAWC, 2013)

“Regulators have responded to the foregoing challenge by adopting new policies to restore balance by mitigating regulatory lag. Key innovations have included construction work in progress, cost trackers, riders, fuel and energy cost adjustment mechanisms, and balancing/true-up mechanisms.” (McDermott, 2012)

MEDA’s past efforts with regard to addressing Missouri’s utility regulatory process have been motivated by a number of factors. For one thing, the lag between when costs or revenue changes occur and when those changes are ultimately reflected in rates is very long in Missouri comparatively. On balance, it takes a full 11 months to process a litigated rate case in Missouri, compared to seven of Missouri’s surrounding states who enjoy a more streamlined process that ranges from 10 months to 180 days. In particular, the time lag between when investments in capital assets must be made and when they can be reflected in rates is extremely lengthy (absent mechanisms like the Infrastructure System Replacement Surcharge (“ISRS”) that permits gas and water utilities to recover certain capital expenditures on a more contemporaneous basis or Construction Accounting which is described in more detail in Section 4 below). This is, in part, due to the statutory prohibition against electric utilities including Construction Work in Progress (CWIP) in rate base. However, it is also due to the significant lag that occurs between the time that capital assets are placed in service (for all utilities), and when they can be reflected in rates. During this period, the utility receives no return at all on its capital investment (since absent Commission authorization, the accounting rules require that AFUDC be stopped when an asset goes into service), and its assets depreciate with no recovery of the depreciation expense. Since most utilities must invest in their systems at a level much greater than their existing assets depreciate, they consistently and systematically lose money.

Significant regulatory lag creates a powerful financial incentive for utilities to limit their investment in their systems to the bare minimum necessary to provide safe and adequate service. This dynamic is to the detriment of customers over the long term whose reliance on utility service expectations are greater than ever, and stifles economic development in the state. (Conversely, mechanisms like the ISRS which permit a more contemporaneous recovery of safety-related and public improvement investments have encouraged the accelerated replacement of aging infrastructure and, in the process, produced jobs and enhanced system safety).

Taking so long to reflect cost changes in rates is neither good for the regulated utilities nor the customers they serve. When costs are escalating, the delay simply decreases cash flows, increases financing costs, erodes earnings on investments that are necessary to provide utility service, and diminishes the level of resources available to provide safe and reliable utility service. When costs are declining, the delay likewise deprives customers of the opportunity to benefit from those reductions in a timely manner. Moreover, there is no reason for such delays given the advances that have occurred over the past three decades or more in the ability to gather, manage, disseminate and analyze the kind of information that is necessary to set rates. In short, we live in a world today where proactive regulatory adjustment mechanisms should be considered and can

be successfully employed to address the negative impacts of severe regulatory lag on utilities and customers alike.

Recommendations for Consideration

There are several alternative regulation and ratemaking approaches, as well as administrative and departmental policy actions, which have, and should be considered, when reviewing policy improvements for utility regulation:

1) Revenue Stabilization/Decoupling

“Between general rate cases, revenue can be stabilized by conservation adjustment or decoupling policies that disconnect the amount of base dollar revenue collected from actual billing unit sales and target revenues to other metrics.” (Pacific Economics Group Research LLC and EEI, 2013) “In many cases, decoupling policies continue to evolve from the same policy basis of the earliest decoupling, which was instituted in California in the early 1980’s. Decoupling is found by regulators as being “in the public interest” when they determine that decoupling increases and restores the base revenue lost when utilities carry out policy directives to pursue aggressive conservation or energy efficiency (EE) targets.” (The Brattle Group and NAWC, 2013) “Demand side management programs (DSM) to encourage energy efficiency and discourage load peakedness can yield large cost savings for customers.” (Pacific Economics Group Research LLC and EEI, 2013)

Over the last decade, groups like the American Gas Association (AGA), the Edison Electric Institute (EEI), the Natural Resources Defense Council (NRDC), The Alliance to Save Energy (ASE), and the American Council for an Energy-Efficient Economy (ACEEE) have worked to encourage state utility regulators to find new ways to encourage energy efficiency through changes in how natural gas rates are designed. In fact, the Board of Directors of the National Association of Regulatory Utility Commissioners (NARUC) has twice passed resolutions in the last decade encouraging state regulatory utility commissions and policy makers to support the expansion of energy efficiency programs and the consideration of mechanisms to ensure that utility’s are able to recover authorized fixed costs. (National Association of Regulatory Utility Commissioners, 2004, 2008)

In Missouri, the MoPSC has also actively addressed this issue in a proactive way for gas utilities by approving rate designs that permit gas utilities to collect more of their fixed costs through fixed charges or low usage blocks. Such rate designs which have been successfully employed for a number of years could potentially serve as a template for other utilities.

a) Usage Adjustments and General Decoupling with Periodic True-up

“General decoupling true-up plans adjust rates periodically to ensure that a utility’s actual revenue tracks the revenue allowed by regulators. Most decoupling true up plans have two basic components: a revenue decoupling mechanism (“RDM”) and an allowed revenue adjustment mechanism (“RAM”). The RDM tracks variances between actual and allowed revenue and makes periodic true ups. To the extent that recovery of allowed revenue is achieved, utilities can use rate designs more aggressively to promote DSM goals. Decoupling true-ups may be made annually or more frequently. More frequent adjustments cause actual and allowed revenue each year to correlate better so that rates fluctuate less from year to year. The size of the true-up that is permitted in a given year is sometimes capped. A “soft” cap permits utilities to defer for later recovery any

account balances that cannot be recovered immediately.” (Pacific Economics Group Research LLC and EEI, 2013). It should be noted that such adjustment mechanisms work both ways. Specifically, they will return money to customers when weather or other factors have increased revenues above targeted levels and allow the utility to adjust rates upward when revenues are less than anticipated.

Twenty-six states (including the District of Columbia) have a general decoupling true-up mechanism for electric companies, thirty states (including Missouri) have this mechanism for gas companies, while 5 states have it for water companies. (The Brattle Group and NAWC, 2013)

b) Fixed Variable Rate Design Solution

In addition to the adjustment mechanisms described above, rates can also be designed in a way that reduces the impact of usage variations on the revenues received by the utility from the outset. For example, under the fixed variable rate design, rates are set to recover all or a large proportion of the utility’s fixed costs, as established in its last general rate case, through fixed customer charges and/or volumetric rate blocks that recover such costs even at relatively low levels of usage. Straight variable rates generally include most or all fixed costs in the customer charge or through a first block rate that is designed to recover such costs once a relatively limited amount of customer usage occurs. The volumetric charges then recover any variable costs, (such as gas costs).” (The Brattle Group and NAWC, 2013) Like the usage adjustment/decoupling mechanism, the fixed variable rate design works both ways, limiting how much customers pay when weather increases revenues above targeted levels and ensuring that the utilities recover, but do not over-recover their fixed costs when revenues fall below targeted levels.

Three states have a Fixed Variable Rate Design for electric companies, while ten states (including Missouri), have such a mechanism for gas companies. (The Brattle Group and NAWC, 2013)

To further encourage the promotion and investment in water and energy efficiency and conservation, revenue stabilization mechanisms as described above should be available to Missouri regulated utilities to remove any disincentive for investment and to allow for the appropriate level of cost recovery necessary to implement efficiency measures. Current statutory provisions that authorize the MoPSC to adopt rules for gas utilities under which they may implement a customer usage adjustment mechanism could serve as a template for the water and electric utilities.

In addition, to continue to provide opportunities for customers who are looking to invest in solar panels and other small-scale, on-site power sources known as distributed generation, net metering policies and cost recovery mechanisms should be updated to provide safe and reliable electricity to all customers, while not shifting the necessary utility infrastructure costs to customers who do not have distributed generation systems.

2) Forward Test Years

General rate cases involve “test years” in which revenue requirements and billing determinants are jointly considered in setting new rates. An historic test year ends before the rate case is filed. A forward test year is a twelve-month period that begins after the rate case is filed. A forward test year typically begins about the time that the rate case is expected to

end. Two-year forecasts are therefore required to span both the rate case year and the year that the rates take effect.¹ In between future test years and historic test years is the option of a “partially forecasted” test year in which some months of historic data on utility operations are combined with some months of forecasted data. Under this approach, actual data for all months usually become available during the course of the rate case. (Pacific Economics Group Research LLC and EEI, 2013)

The fact is “regulatory commissions have always been in the business of projecting, whether they knew it or not. When they used historic test year statistics, fully verifiable and verified, graven in stone, as the basis of future rates, they were in fact projecting. They were assuming that the future would be similar to the past. It is no more speculative, then, to make the best possible estimate of future costs when setting future rates: and honesty compels it.”²

Fifteen states allow the use of a Future Test Year for electric and gas companies and seventeen states allow the use of a Hybrid or Transitional Future Test Year for electric and gas companies. While Missouri unfortunately does not allow the use of a Future Test Year for water companies, nineteen other states, including neighbors like Illinois, Arkansas, Kansas, and Nebraska, allow the use of this valuable mechanism. (The Brattle Group and NAWC, 2013)

3) *Interim Rates Subject to Refund*

To address the pernicious impact of severe regulatory lag, utilities should be permitted to implement interim rates to reflect some or all of the increases in costs during the pendency of the rate case. These interim rates would be subject to full or partial refund based on (a) prudence disallowances, or (b) a total rate increase that did not exceed the interim rate increase.

4) *Construction Accounting*

The adoption of “construction accounting” for all capital investment between rate cases should be considered, or at least the portion of capital investment that exceeds the utility’s depreciation expense. Construction accounting has been used for major capital assets for many years in Missouri. Construction accounting permits the utility to continue accruing “AFUDC-like” on its investment until the time when the investment is reflected in rate base. In addition, it permits the utility to defer depreciation on the asset until the depreciation expense can be reflected in rates. In short, it eliminates the time period when the utility is completely unable to recover a return on or a return of its investment and it eliminates the disincentive to investment that currently exists due to the severe regulatory lag discussed earlier.

5) *Targeted Forecasts, Riders or Trackers*

Consider addressing use of forecasts or targeted riders (i.e., rate adjustment mechanisms) or trackers (deferral mechanisms) when specific items are changing substantially from year-to-

¹ A forward test year can be the rate case year, and thereby not require two-year forecasts, if rates are allowed to be changed as proposed on an interim basis shortly after the filing.

² Section 7.02 of *Accounting for Public Utilities*, Robert L. Hahne and Gregory E. Alliff (Mathew Bender Publication), quoting a 1975 article written by Professor Dr. Alfred Kahn, who was Chairman of the New York Public Service Commission at the time the article was written.

year such that identifying a “normal” or “expected” level for such cost of service items during the period when rates will be in effect is difficult. Recent examples in the electric industry include:

- Transmission fees paid to regional transmission organizations;
- Property taxes; and
- Critical infrastructure protection and cyber-security efforts.

21st Century Grid Modernization and Security Act

1) The Problem

The electric service provider industry is facing a number of unprecedented challenges, such as loss of load growth or even load contraction, significant aging infrastructure, rapidly accelerating expectations of customers for a modern grid, an increasing clip of mandated expenditures that further challenge available capital, and capital investment needs and investor views of Missouri versus other jurisdictions.

Missouri’s investor-owned utilities are critically focused on working with stakeholders to modernize our regulatory framework to better meet the needs and expectations of customers for safe, dependable, secure and cleaner energy and water resources. The status quo does not serve Missouri and its utility customers well and if not addressed in a serious manner, will become a much larger problem in the future.

2) The Proposed Solution (2016 Legislative Session)

Senate Bill 1028 was filed during this past session as the result of ongoing efforts to develop a regulatory framework that would enable important investments to modernized Missouri’s aging grid while holding investor-owned electric utilities accountable. Feedback from stakeholders resulted in a proposal that included strong customer benefits, including more stable and predictable rates, profit caps, infrastructure plans and performance metrics with expanded oversight responsibilities by the MoPSC.

Specifically, SB 1028 contained the following key provisions:

- Caps on electric utility revenue requirements that insure that customers’ rates will be far more stable and predictable in the future than they have been in the past. All of the caps were well below what customers have experienced over the last decade.
- The MoPSC, would have continued to have strong oversight authority and retention of its full responsibilities for auditing the books and records of electric utilities to ensure that rates were based only on prudently incurred costs. Other parties would have also had the opportunity to challenge a utility’s cost of service.
- Performance metrics would have held investor-owned electric utilities accountable for demonstrating that investments are delivering benefits to customers.
- A hard annual cap would have been placed on electric utility company earnings with money back to customers if the utility over-earned.
- For the first time ever, the proposed legislation would have improved utilities’ access to capital while giving the MoPSC the power to cap utility profits and return overearnings to customers.

Conclusion

Our organization stands ready to continue a positive discussion around how to improve Missouri's regulatory environment. We believe we have brought a credible proposal to the table and we look forward to additional dialogue with stakeholders to find a solution.

On behalf of MEDA I would like to thank you again for the opportunity to provide comments and please don't hesitate to contact me if you have any questions or need further information.

Sincerely,

/s/ Trey Davis
Trey Davis
President

Works Cited

- McDermott, D. K. (2012, June). *Cost of Service Regulation In the Investor-Owned Electric Utility Industry, A History of Adaptation*. Retrieved 2014, from www.eei.org:
http://www.eei.org/issuesandpolicy/stateregulation/Documents/COSR_history_final.pdf
- National Association of Regulatory Utility Commissioners. (1994-2008). Retrieved 2015, from www.naruc.org: <http://www.naruc.org/Policy/Resolutions.cfm>
- National Association of Regulatory Utility Commissioners. (2004, 2008). Retrieved 2015, from www.naruc.org: <http://www.naruc.org/Policy/Resolutions.cfm>
- National Association of Regulatory Utility Commissioners. (2014, November 19). Retrieved 2015, from www.naruc.org:
<http://www.naruc.org/Resolutions/14%201119%20NARUC%20Board%20Substantive%20Resolutions%20Packet.pdf>
- Pacific Economics Group Research LLC and EEI. (2014, December 12). *Alternative Regulation for Evolving Utility Challenges: An Updated Survey, Chapter III Revenue Decoupling and State Electric Efficiency Regulatory Frameworks*. Retrieved from www.basecamp.com:
<https://basecamp.com/2762315/projects/7475791/attachments>
- The Brattle Group and NAWC. (2014, December 12). *Alternative Regulation and Ratemaking Approaches for Water Companies*. Retrieved from www.basecamp.com:
<https://basecamp.com/2762315/projects/7475791/attachments>