DRAZEN CONSULTING GROUP
Energy & Regulatory Economics

November 30, 2012

Missouri Public Service Commission
200 Madison Street
P.O. Box 360
Jefferson City, MO 65102-0360

Re: In the Matter of a Working Case to Consider the Establishment of a Rate Stabilization Mechanism to Reduce the Need for Frequent Rate Case Filings

Commissioners:

The comments filed today regarding the consideration of establishing a rate stabilization mechanism to reduce the need for frequent rate case filings are on behalf of Barnes Jewish Hospital.

Regulation of a utility is to keep costs fair and reasonable for customers and for the utility. A successful rate stabilization mechanism (RSM) will achieve this goal, not at the expense of customers or the utility. The purpose of a RSM is not only to reduce the frequency of rate cases, but to provide fair and reasonable rates.

A rate stabilization mechanism for regulated utilities in Missouri could expose ratepayers to higher than necessary rate increases. A RSM should be designed so that utilities are incented to lower their costs. The allowed range for the RoE should be reasonable and not set artificially high. If it is too high the utility will not have the incentive to lower its costs.

Another way to incent a utility to lower its costs is to require a utility to refund any earnings that are above its allowed return on equity (RoE) range. Requiring the utility to refund to customers any amount that it earns above the allowed range is fair because the utility is getting a guaranteed rate increase each year that is based on a forward looking test year. If the forecast provided by the utility is too high, then the utility benefits at the expense of the customers. A refund mechanism ensures that customers will not pay more than is necessary for their utility service. In this way a RSM limits the ability of a utility to overstate its costs. Furthermore, a forward looking test year reduces regulatory lag, which lowers a utility's risk, which is another reason to reduce a utility's allowed RoE range.

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An effective RSM should limit a utility's common equity ratio and/or limit the amount its common equity ratio can increase in a year. It should also have an overall cap on the common equity ratio. If not, then a utility's total rate of return may increase and result in much higher rates for customers, even if the utility's earned return on equity is within the allowed range. For example, if a utility's recommended RoE range is 9.5%-10% and its common equity ratio is 45%, then its common equity portion of the rate of return (RoR) is 4.275% - 4.5%. However, if the utility increases its common equity ratio in the following year to 48%, while its recommended RoE range is 9.5%-10%, then its common equity portion of the RoR is increased to 4.56% - 4.8%, which leads to a higher overall rate increase.

The RSM should set a limit on the annual rate increase and should also limit cumulative rate increases a utility may receive over a period of years. For example, if the annual rate increase limit is 3% per year and the cumulative rate increase is 5%, then if a utility increases its rates by 3% in year one, it may not increase its rates over 2% in year two. These limits prevent rate shock for rate payers.

A properly designed and implemented rates stabilization mechanism may provide reasonable, low cost rates for rate payers while incenting a utility to lower its costs, while at the same time allowing a utility to earn a reasonable return on equity. For these reasons, a RSM may be considered as an alternative form of regulation in the State of Missouri. A RSM should not be implemented to merely reduce the frequency of rate cases, which could harm ratepayers.

Very truly yours,

DRAZEN CONSULTING GROUP, INC. on behalf of Barnes Jewish Hospital

Billie S. LaConte

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