REGULATION

AN UPTICK AMONG DOWNWARD TRENDS

By Cass Bielski

Rising rate-case activity is a long-term trend in the shareholder-owned electric utility industry, driven by rising fuel costs, labor and materials cost inflation, and rising capital spending for environmental upgrades and new generation needed to meet growing power demand and to replace aging infrastructure. In the second quarter of 2008, utilities filed eight general rate cases.

But while public utility commissions awarded a slightly higher average return on equity (ROE) of 10.41 percent during the quarter, compared to the previous one, it was not significant enough to indicate a change in the long-term trend of lower allowed ROEs. (See Figure 1.) Declining interest rates account for most of the long-term decline, but more recent attempts by utility commissions to constrain rising rates are also a likely factor.

At the same time, the industry average requested ROE was 10.93 percent—the lowest in Edison Electric Institute's 20-year historical dataset. (See Figure 2.) This further confirms the downward ROE trend. The lowest requested ROE in the second quarter was Consolidated Edison's 10.0 percent. Moreover, Con Ed is currently operating under a 9.1-percent ROE, awarded in its previous case filed last year. This is the lowest in the nation and the lowest ROE awarded in decades. Consequently, Con Ed's reduced financial expectations are understandable.

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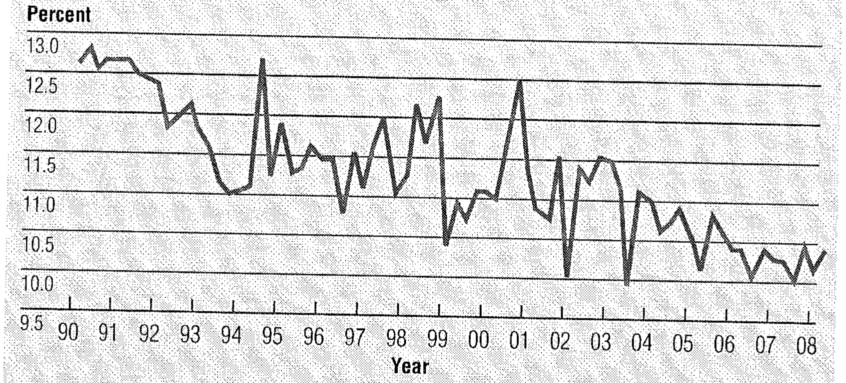
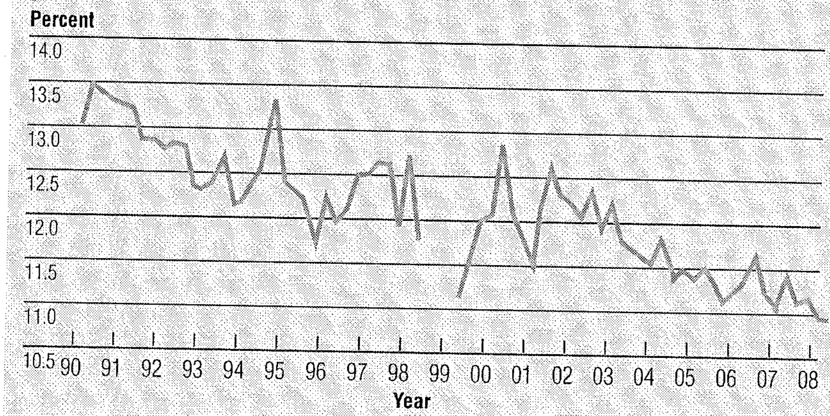
FIGURE 1
AVERAGE AWARDED RETURN ON EQUITY FOR U.S. SHAREHOLDER-OWNED ELECTRIC UTILITIES, 1990-2008
(2nd quarter)



Source: SNL Financial, Regulatory Research Associates, and EEI rate department

FIGURE 2
AVERAGE REQUESTED RETURN ON EQUITY FOR U.S. SHAREHOLDER-OWNED ELECTRIC UTILITIES, 1990-2008
(2nd quarter)



Source: SNL Financial, Regulatory Research Associates, and EEI rate department

Regulatory Lag

During the second quarter, the average regulatory lag (the time between rate filing and commission decision—a rough proxy for the time between when money is needed and when it can be recovered in rates) was 10.8 months, consistent with the 10.7-month average of the past two decades. (See Figure 3.) Regulatory lag has been volatile over that time, particularly in the late 1990s and the early 2000s during industry restructuring.

Utilities use several strategies for reducing regulatory lag in states that allow such methods, such as projecting expenses in a rate case and recovering some expenses between rate cases through fuel and other adjustment clauses. In the second quarter, for example, AmerenUE applied to implement a fuel adjustment clause in Missouri, and Westar Energy applied to implement an environmental cost-recovery rider in Kansas. MDU Resources' settlement allows it to implement a fuel and purchased power adjustment. Sierra Pacific Power, however, was denied its request to project expenses in its case in Nevada.