

Schedule 1

# Rate Stabilization and Equalization (RSE) Overview



## Philosophy of Alabama's rate structure

To stabilize customer rates as much as possible throughout the year and from year to year, while recovering the utility's costs

- Customers are not exposed to unexpected fluctuations in their rates even though the utility's costs may fluctuate during the year and from year to year
- The utility is provided a reliable and predictable revenue stream to recover its costs



## Rate stabilization and equalization (RSE)

RSE is the formulaic ratemaking process, in place for Spire Alabama since 1983 and for Spire Gulf since 2002, in which base rates are established to generate the revenue required to achieve the APSC-authorized return on average equity for the upcoming rate year based on the budget approved the utility's Board of Directors.

- Method of increasing/decreasing base rates, on a pro-rata basis, to rates that existed when RSE was implemented
- Forward-looking (based upon budget), streamlined method designed to ensure:
  - Stable rates for customers
  - Opportunity of an authorized ROE with no regulatory lag
- Recovers the Company's operating/non-gas costs including:
  - O&M expense (salaries and benefits, utilities, rent, etc.)
  - Depreciation of plant
  - Taxes (income, property, revenue)
  - Interest expense
  - Return on equity



## Advantages of RSE

- Eliminates cumbersome rate case process and the associated expense
- Formulaic approach provides clear rate-setting methodology
- RSE has de-politicized the ratemaking process (*only* the ratemaking process)
- Non-adversarial relationship with regulators
- Allows for quarterly adjustments to rates, provides more rate stability
- Realistic opportunity to earn authorized ROE
- Frees up management's time to address important issues
- Contains a variety of consumer safeguards



## How does RSE work?

- Recovers non-gas costs
- Based on annual budget as approved by the Board of Directors
- Based on a negotiated RSE term (AL 10/1/2018- 9/30/2022; Gulf 10/1/2017- 9/30/2021)
- The APSC establishes the rate of return the Company is allowed to earn on its average equity
  - AL - return on average equity (ROE) range is between 10.15% – 10.65%, with an adjusting point of 10.40%
  - Gulf – return on average equity (ROE) range is between 10.45 – 10.95%, with an adjusting point of 10.70%
- Contains several consumer safeguards:
  - Cost Control Measurement (CCM) is an incentive to contain O&M costs per customer
    - Inflation-based (% +/- 1.50%) band around June's CPI-U
    - Excess over cap requires a give-back to customers of 75%
    - Amounts under cap results in benefit to the Company of 50%
  - Annual rate increase cap (4% of prior revenues)
  - Year-end equity cap (limits the equity on which a return can be earned to 55.5% of total capitalization)
  - Only one increase per year December 1, *based on the Board-approved annual budget*



## How does RSE work? (continued)

### APSC-required auditing and monitoring provisions:

- Monthly, quarterly, and annual reporting
- Annual meeting requirements (May/Jun for RSE annual mid-year update, Aug/Sep for parent allocations review)
- Opportunities for decreases on April 1, July 1, October 1 and December 1 (based on RSE points of test results at January 31, April 30, July 31 and September 30)
- Certain expenses disallowed (lobbying, country club and civic club dues, charitable donations, etc.)



## Why is our budget so important?

- The budget is not only a financial tool or target, but Alabama's customers rates are set at December 1<sup>st</sup> each year based on our annual budget with one opportunity to get it right
- Rates are derived based on a revenue requirements model
- Timing is important due to the RSE points of test and the potential impact to earnings



## Revenue requirements model

<b>Net income (equity x allowed rate of return)</b>	<b>XX</b>
Add: O&M	XX
Depreciation	XX
Interest expense	XX
Income taxes	XX
Net spread (margin)	XX
Add: Cost of gas	XX
<b><u>Revenue requirement (volume x rate)</u></b>	<b><u>XX</u></b>





## Variables impacting budget

- Volume projection (amount and timing)
  - Customer number projection
  - Use per customer projection
- Projection of inflation rate (impact on O&M cap, on budgeted increases for all costs, rate increase for special contracts for some LCI customers)
- Timing of revenues and expenses (RSE points of test)
- Interest rates
- Non-discretionary increases (benefits)



## RSE points of test

- Periodically throughout the year, a review is performed to determine whether the ROE will be within the range at the end of the fiscal year. If, at any ***point of test***, projections indicate the company's fiscal year ROE will exceed the range allowed, rates are decreased. If, however, projections indicate the ROE will be below the range, ***no adjustment is made***.
- RSE points of test occur:
  - January 31<sup>st</sup> (if adjustment is required, rates are lowered on April 1<sup>st</sup>; overearnings are passed back to customers Apr 1<sup>st</sup> through following March 31<sup>st</sup>)
  - April 30<sup>th</sup> (if adjustment is required, rates are lowered on July 1<sup>st</sup>; overearnings are passed back to customers July 1<sup>st</sup> through following June 30<sup>th</sup>)
  - July 31<sup>st</sup> (if adjustment is required, rates are lowered October 1<sup>st</sup>; overearnings are passed back to customers October 1<sup>st</sup> through following September 30<sup>th</sup>)
  - September 30<sup>th</sup> (if adjustment is required, rates are lowered December 1<sup>st</sup>; overearnings are passed back December 1<sup>st</sup> through following September 30<sup>th</sup>)
- Timing of revenues and expenses affect the RSE points of test



## RSE, rates, and net income at RSE points of test

<u>Budget Variance</u>	<u>Rate Impact</u>	<u>Net Inc Impact</u>
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Revenue > Budget	Lower	None
Revenue < Budget	None	Lower
Expenses > Budget	None	Lower
Expenses < Budget	Lower	None



# APSC rules & regulations

- Link to APSC Rules & Regulations:

[http://www.psc.alabama.gov/Administrative/administrative\\_division.htm](http://www.psc.alabama.gov/Administrative/administrative_division.htm)

- General Rules
- Rules of Practice
- Natural Gas Rules
- General Rules and Regulations Governing Uniform System of Accounting and Reporting of Utilities

- Spire Alabama and Gulf's APSC-approved tariffs can be found on our website at <https://spireenergy.com/rates-and-tariffs>

