BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

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.	)))	**File No. AW-2013-0110**

<u>INITIAL COMMENTS ON BEHALF OF</u>
<u>AARP AND THE CONSUMERS COUNCIL OF MISSOURI</u>

COMES NOW AARP and the Consumers Council of Missouri, in response to the Missouri Public Service Commission's ("Commission's") invitation to comment upon "proposals to stabilize rates", and hereby offers the attached comments of former New Hampshire Public Utilities Commissioner **Nancy Brockway** for consideration in this working docket. A wide variety of issues and diverse mechanisms have been labeled "rate stabilization" in other jurisdictions, and Ms. Brockway brings to this discussion extensive experience gained through the official capacities she has served at multiple public utility commissions. It is hoped that her analysis of these issues will aid the Commission in its deliberations.

Respectfully submitted,

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INITIAL COMMENTS ON BEHALF OF AARP AND THE CONSUMERS COUNCIL OF MISSOURI

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November 30, 2012

These comments have been prepared on behalf of AARP and the Consumers Council of Missouri (Consumers Council) in response to the September 20, 2012 Order (Order) opening this working docket AW-2013-0110 regarding a "rate stabilization mechanism" and the invitation to stakeholders to comment on "proposals to stabilize rates". The Missouri Public Service Commission (Commission) has a commendable tradition of providing consumers the opportunity to testify at many local public hearings, and the Order states that this docket was opened in response to consumer complaints expressed at those hearings regarding frequent and significant rate increases.

I have extensive experience with utility rate cases and rate-making, and how rate-setting approaches affect incentives for utility behavior. As a New Hampshire Public Utilities Commissioner from 1998-2003, I sat on dozens of cases dealing with adjustment clauses, pre-approval, multi-year rate plans, and other alternatives to traditional cost-plus rate-setting. The Commission was charged with sheparding the utilities through the transition to retail competition, a process which required deep analysis of the purposes and practical effects of regulation, traditional and proposed. I had similar direct experience with such issues during my tenure as General Counsel of the Massachusetts Department of Public Utilities, and earlier as a hearing officer and staff advocate with the Maine Public Utilities Commission. As a

Commissioner and a staff member, I have been responsible for developing and reviewing multi-year rate plans intended, among other things, to manage the rate shock that can accompany stranded cost recovery. In my consulting practice, I have testified on alternative rate-setting proposals in Pennsylvania, Missouri, and the province of Nova Scotia, and decoupling alternatives (intended to stabilize earnings) in Kentucky, Ohio, New Mexico, Arizona and Kentucky. As part of my work on energy efficiency, rate design, and smart grid evaluation, I have written and testified on such issues as revenue erosion, customer charges, and revenue volatility. While at the National Regulatory Research Institute (NRRI), I performed the original research and prepared the first draft of what became an NRRI report on varieties of forward approval of capital investment.

AARP is a nonprofit, nonpartisan membership organization that helps people 50+ have independence, choice and control in ways that are beneficial and affordable to them and society as a whole. AARP has members residing across the state and representing all segments of the socio-economic scale. Moreover, a substantial percentage of AARP's members live on fixed or limited incomes and depend on reliable electric service for adequate heat, lighting, and powering life-saving medical devices.

Consumers Council is a nonprofit, nonpartisan membership organization dedicated to educating and empowering Missouri consumers and to advocating for their interests.

1. The term "Rate Stabilization Mechanism" does not have a common or consistent definition.

In its Order opening this proceeding, Commission solicits comments on possible means of reducing the need for electric utilities to file for frequent rate increases. In particular, the

Commission asks the parties to address a mechanism that would "award the utility a higher return on equity within the range of reasonable returns, but would then reduce that allowed return on equity to a lower rate within the range of reasonable returns if the utility sought a rate increase within the stabilization period." The Commission refers to this as a "rate stabilization mechanism." The incentive/penalty scheme described by the Commission in its Order is one aspect of a wide variety of ratemaking mechanisms that have the purpose or effect of lengthening the time between rate cases.

There are many types of rate designs and revenue-setting mechanisms, with very different impacts, that have been tried in the name of rate stabilization. They vary in the period of time during which rates remain "stable." They also vary in the range of rate changes a utility may make during the stability period, from no changes at all, to changes under certain circumstances, to changes within certain limits. Within this last set, the circumstances that trigger, allow, or require rate changes during the stability period include such options as (a) if the utility's earned return falls below or exceeds some limit, (b) if certain external events happen, such as a decrease in financing costs or an increase in tax rates, for example, and (c) if a utility falls below or exceeds some measures of service quality. Another major consideration in exploring ways to stabilize rates is the extent to which variances between anticipated and actual costs and revenues are reconciled either in the period or between periods.

Given the lack of specificity in the Commission's description of a rate stabilization mechanism, it is difficult to comment on the impact that such a mechanism would have on residential ratepayers. Moreover, AARP and Consumers Council do not believe a rate stabilization mechanism is necessary or beneficial for consumers. Therefore, these Initial

Comments will discuss the general ways in which alternative ratemaking, including rate stabilization mechanisms, shift risk to consumers and threaten just and reasonable rates. AARP and Consumers Council will comment on any specific proposals in Reply Comments.

2. <u>Alternative ratemaking, including rate stabilization mechanisms, shifts risk to ratepayers</u>.

As with all regulatory strategies, core issues for the Commission to consider include (a) the extent to which the Commission has the legal authority to institute the particular form of rate-setting, and (b) the impact of the mechanism on the incentives for the utility to provide safe and adequate service at just and reasonable rates, on a going forward basis.

With respect to the question of jurisdiction, it would be difficult to fashion a legally enforceable multi-year rate plan. Missouri counsel advises me that case law precedent makes it unlikely that the Missouri Commission could ever legally enforce an order that a utility "stay out" or otherwise prevent that utility from initiating a rate increase proceeding, absent perhaps a settlement between that utility and other rate case parties. Even an order approving a voluntary agreement to a plan might not be immune from a utility's right to procedurally argue that its profits during the plan had become so low as to as to render the plan a "taking." To the extent the plan can be broken on such a showing despite a utility's voluntary agreement otherwise, it is not "stable," at least from the perspective of the consumer. Further, if a utility is not bound by the terms of a "stay-out" agreement or order, it gets an assured stream of revenues without giving consumers an assured stream of benefits. No matter the form of stabilization mechanism, then, it involves giving the utility a net benefit over consumers that it would not otherwise deserve.

Another set of problems with rate stabilization schemes is that the future is always different from our best forecasts. Projecting costs and revenues even one or two years ahead produces estimates that will vary from the assumptions on which the rate stabilization package was crafted. These variances can go either in favor of higher returns or in favor of lower returns. It becomes essential to determine which party, the utility or its customers, will bear the risk or reap the benefit from such variances. The longer the stabilization period, the more likely that there will be variances from the rate making assumptions, and the larger these variances may be.

A revenue requirement that produces “just and reasonable” rates in the near term is likely not to produce such rates, as various costs and revenues move up and down in actuality. The goal of preventing a rate case will not prevent changes in the justness and reasonableness of rates. It will just hide those changes. The Commission will also have to be alert to the possibility that rates would have been likely to go down during the stabilization period if they were adjusted as frequently as the actual circumstances dictated.

A utility will be more likely to accept a "stay-out" requirement to the extent the utility can shift its earnings risk during the stabilization period to the consumer. But to the extent the utility is no longer at risk for earnings erosion, it will have a lowered incentive to take steps to keep its earnings up. Managing the business efficiently becomes less important to utility management, to the extent that costs are passed through to customers.

Alternative ratemaking, such as rate stabilization mechanisms, usually retain the reconciling fuel clause, and sometimes include trackers for other costs. Such clauses allocate the risk of deviations from the forecast to the consumer. Note that if a tracker is necessary to make a rate stabilization package acceptable to the utility, this fact by itself suggests that costs will likely not be stable. The allowed return should be lowered to reflect the utility's lowered risk, of course, but even that necessary adjustment does not restore the incentive for the utility to keep its costs down during the rate stabilization period. Because the utility will enjoy dollar-for-dollar recovery of such costs, it will be assured cost recovery unless its management can be shown to have been imprudent. Absent a rate case, however, it will not be possible to review the prudence of the utility's management of such costs.

It is sometimes argued that Commissions can determine prudence of costs under a reconciling tracker during the periodic filings of such costs by the utilities. However, it is not practical to conduct a thorough investigation of cost management quarter by quarter, or even year by year. And to the extent the Commission does so, it has lost much of the benefit of attempting to limit the frequency of rate cases. Also, in the case of trackers for capital plant investments, it is impossible to know if any given expenditure was imprudent until the project is complete, and even then it is wasteful of Commission resources to review every decision. A rate case, by contrast, provides a forum where excessive costs can be identified, and their prudence determined.

3. Conclusion

For all the above reasons, alternative ratemaking, including rate stabilization, is a rate-setting approach fraught with risks. It will perhaps reduce the frequency of rate cases, but does so by shifting risks, typically from the utility to the consumer. There is no standard or ideal rate stabilization mechanism, and each proposal must be considered carefully in light of the risks of unintended consequences, as described above.