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Investment
The Missouri Experience

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Rate of Return Regulation

Revenue Requirement = E + D + T + R x RB

Where:

E	=	Operating expense requirement
D	=	Depreciation on plant in rate base
T	=	Taxes including income tax related to return
R	=	Return requirement
RB	=	Rate base which consists of gross plant, accumulated depreciation and other rate base items

Implications For Investment

When Commission is setting Revenue Requirement:

Financial Rating Agencies want:	Ratepayers want:
• High return (R) • High gross plant value • High amount of depreciation (D) • Expenses covered • Viable utility	• Low bills • Viable utility

After Commission sets Revenue Requirement:

Financial Rating Agencies want:	Ratepayers want:
• Minimize additional gross plant expenditures • Reduce expenses	• Low bills • High level of reliability and service

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Additional Complexity in Missouri

§ 393.135 RSMo

Any charge made or demanded by an electrical corporation for service, or in conjunction therewith, which is based on the costs of construction in progress upon any existing or new facility of the electrical corporation, or any other cost associated with owning, operating, maintaining, or financing any property before it is fully operational and used for service, is unjust and unreasonable, and is prohibited.

Adopted by Initiative, Proposition 1, November 2, 1976

Translation from Legalese to Common Language

- An electric utility cannot include any construction work in progress as “gross plant” in revenue requirement formula
- The utility must finance any large construction program
- The Commission must determine that the plant is fully operational and used for service before ratepayers start paying for the plant

Measures to Keep Investment in Missouri Utilities

- Resource planning rules
- Mechanisms that allow cost recovery in between rate increase cases
- Other cost recovery mechanisms

Resource Planning

- Objectives:
  - To provide the public with energy services that are safe, reliable and efficient at just and reasonable rates
  - In compliance with all legal mandates
  - Consistent with state energy and environmental policies
- Requirements:
  - Consider and analyze supply-side and demand-side resources including renewable energy
  - Use minimization of long-run costs as primary selection criteria
  - Identify and quantify risks and uncertainties

Resource Planning Commission Action

- If the Commission finds that the plan achieves substantial compliance with the resource planning requirements, the Commission may acknowledge the utility's resource plan or acquisition strategy as reasonable.
- Acknowledgement does not bema a finding as to prudence, pre-approval or Commission authorization of any specific project.
- Acknowledgment may be used as supporting evidence in future Commission proceedings

Why is This Important to Financial Rating Agencies?

- Good resource planning ➔ Sound resource decisions

- Commission acknowledgement, while not as good as pre-approval, may give investors more confidence that the Commission will approve the inclusion of construction costs in rates.

Special Cost Recovery Mechanisms

Utilities in Missouri are not allowed to change their charges to customers between rate case except for the following surcharges/adjustments/mechanisms:

- For the electric utilities:
  - Fuel and Purchased Power Cost Recovery Mechanism
  - Environmental Cost Recovery Mechanism
  - Demand-Side Programs Investment Mechanism
  - Renewable Energy Standard Cost Recovery
- For the gas utilities”
  - Infrastructure System Replacement Charge
  - Purchased Gas Adjustment/Actual Cost Adjustment

Why are These Important to Financial Rating Agencies?

These types of charges/adjustments between rate increase cases reduce the risk of the utility not recovering its costs and earning a return.

Without these mechanisms, increases in costs between rate cases erodes utility earnings.

Fuel and Purchased Power Adjustments

- § 386 RSMo passed by Missouri Legislature in 2005
- Rules effective January 2007
- Allows for recovery of historical fuel costs offset by off-system sales revenues
- Trued-up 2 or 3 times a year
- Prudence audit at least every 18 months
- Incentive mechanism
  - Utility only recovers (or returns) 95% of the difference between the actual net costs and the net costs in the revenue requirement in the utility's last rate case

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Environmental Cost Recovery Mechanism

- § 386 RSMo passed by Missouri Legislature in 2005
- Rules effective October 2009
- Allows for recovery of and variable environmental expenses and capital costs of construction to meet environmental requirements (after shown to be operational and used for service)
- No electric utility currently has an Environmental Cost Recovery Mechanism

Demand-Side Programs Investment Mechanism

- § 393.1075 RSMo passed by Missouri Legislature in 2009
- Rules effective October 2011
- Allows for
  - Cost recovery of energy efficiency programs administered by the utility
  - An incentive payment to the utility for successful programs
- Two electric utilities currently have applications for this mechanism before the Commission

Renewable Energy Standard Cost Recovery

- Part of voter initiative establishing Renewable Energy Standard (RES) in 2008
- Allows for recovery of the costs of meeting the RES if the costs are not already included in revenue requirement and if the costs are higher than what the utility would have incurred otherwise
- Capped at 1% above what rates would have been without the RES

Purchased Gas Adjustment Clause

- Not defined by Statute or Rule – Tariffed recovery mechanism
- Natural Gas has been partially deregulated – the cost for the gas itself is determined by free market; the cost for interstate transmission pipelines is determined by the Federal Energy Regulatory Commission (FERC)
- Remaining costs are approved by normal rate case process

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Purchased Gas Adjustment Clause (continued)

- Purchased Gas Adjustment Clause (PGA) collects the gas and the transportation
- Utility is required to file at least once per year but has the option of filing four additional times
- Utility attempts to estimate the PGA to collect the correct amount
- Under or Over Collections for a one-year time period are collected the following year using the Actual Cost Adjustment (ACA) factor and are subject to interest compounding

Additional Deferred Cost Mechanisms

- Deferred costs can be collected using **amortizations**
- Two Step Process: 1) Determine amount to be deferred 2) collect that amount over some future period based on decision in Rate Case
- Often collected over a period of 3 to 5 years
- Regulators attempt to use amortizations as infrequently as possible
- Typically granted for extraordinary and unusual circumstances that are significant – allowing Utility to defer costs does not guarantee cost recovery

Additional Deferred Cost Mechanisms (Continued)

- Trackers are also used
- A Tracker compares actual costs to amount built into rates over a long period of time
- Under or Over Collection is deferred until next rate case
- Remaining balance is often amortized over a 3 to 5 year period
- Used to support a specific policy or to collect costs that are unpredictable

Additional Deferred Cost Mechanisms (Continued)

- Example of a Tracker: Missouri recently implemented rules on Vegetation Management (Tree Trimming)
- Considered good public policy that would reduce the outages caused by vegetation
- These new rules resulted in costs that were different than historic levels (but costs were close to budgeted levels)
- Balance of Tracker was included in rates in next rate case

Reason Customers Invest in Their Own Generation

- Monetary
  - Avoided capacity and energy payments from the utility
  - Rebates from the utility
  - Tax credits
  - Grants (gifts of money usually from the government but sometimes from other organizations)
- Reliability
- Non-monetary

Approaches of Other States

Common Theme: Provide stable earnings and move risk of cost recovery from the utility – typically to the utility's customers

- Preapproval of large construction projects
- Allowance for Construction Work In Progress
- Previously described adjustment mechanisms
- Decoupling of rates
- Rate cases at prescribed times, for example every two years