

Overview of Formula Rates in 7 States

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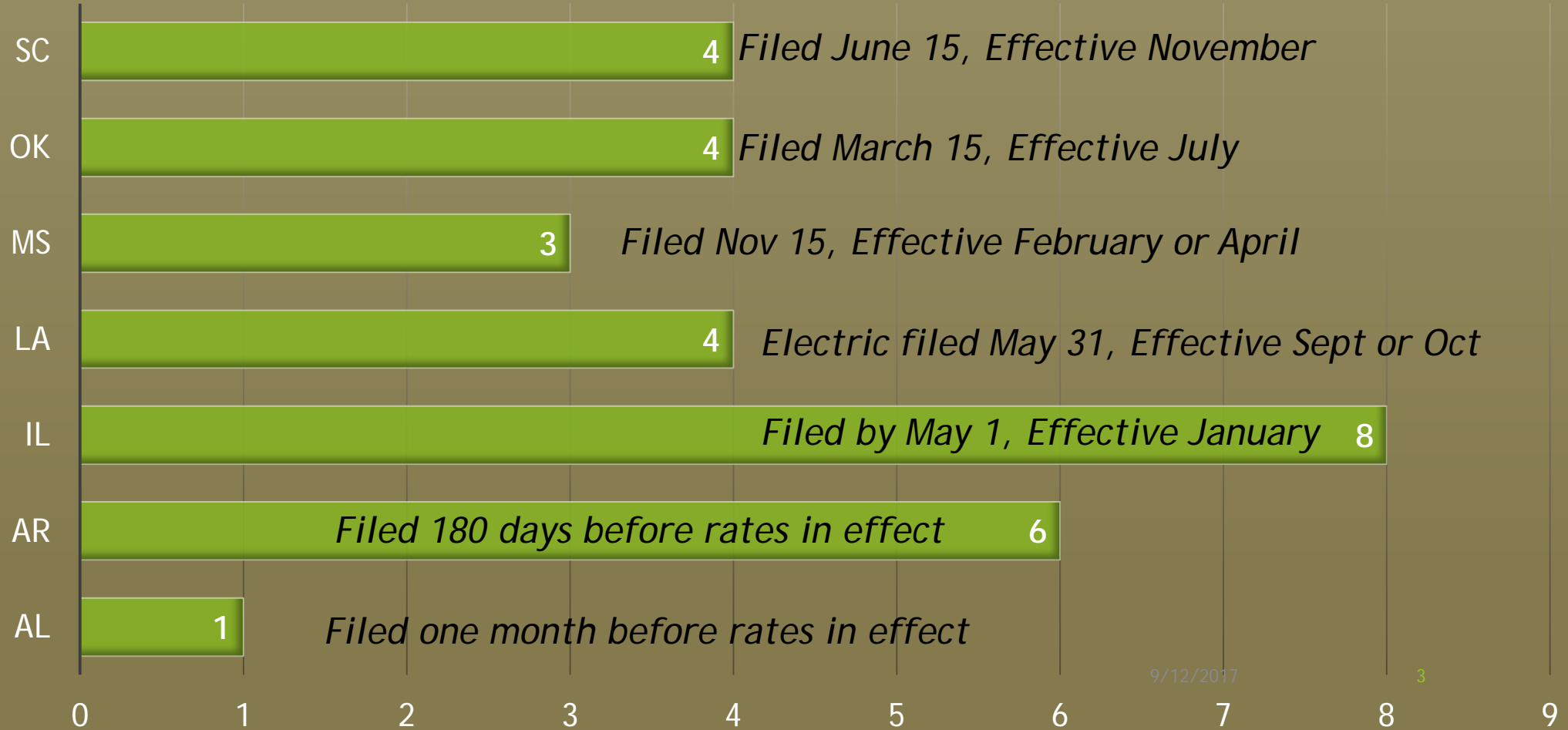
NARUC Staff Subcommittee on Accounting & Finance Meeting

Formula Rates - Caveats

- ▶ Disclaimer: The information I present today should not be construed to represent the opinions or viewpoints of the Illinois Commerce Commission or of its staff.
- ▶ Formula rates differ across states. And within the same state, they can differ between gas and electric. And within the same industry, they can differ across companies. Thus, some generalizations were necessary. Refer to the state statutes, orders or company tariffs for complete information.

Formula Rate Annual Proceedings

Approximate Length (Months)



Authority & Applicability



Per State Law

- ▶ **2015 March** - Arkansas (Act 25 and Administrative Code 23-41201 - Formula Rate Plan)
 - ❖ All IOUs. Entergy AR, OG&E, CenterPoint Energy AR Gas.
- ▶ **2011 October** - Illinois (Section 16-108.5 IL Public Utilities Act - Performance Based Formula Rate)
 - ❖ Investor owned electrics: Commonwealth Edison (Rate DSPP) and Ameren IL (Rate MAP-P)
- ▶ **2005 February** - South Carolina (Article 4, Section 58-5-400 to 480 - Rate Stabilization Act)
 - ❖ Investor owned gas: South Carolina Electric & Gas, and Piedmont Natural Gas

Per Commission Order

- ▶ **1982** - Alabama (Rate Stabilization & Equalization)
 - ❖ Investor owned electric & gas: Alabama Power, Alabama Gas Co., Mobile Gas Service Corporation.
- ▶ **1996 (electric) & 2005 (gas)** - Louisiana (Formula Rate Rider)
 - ❖ Atmos Energy (Rider RSC), AEP/SWEPCO, CenterPoint Energy, CLECO, Entergy LA and Gulf States, South Coast Gas
- ▶ **Late 1990s** - Mississippi
 - ❖ Investor owned electric & gas: Mississippi Power (PEP-5A), Entergy MS (FRP-6), Atmos Energy (Stable/Rate Adjustment Rider), Wilmut Gas & Oil (Rider RSA)
- ❖ **2004** - Oklahoma (Performance Based Rate Change Plan)
 - ❖ Investor owned Gas: Oklahoma Natural Gas and CenterPoint Energy Oklahoma Gas Company.

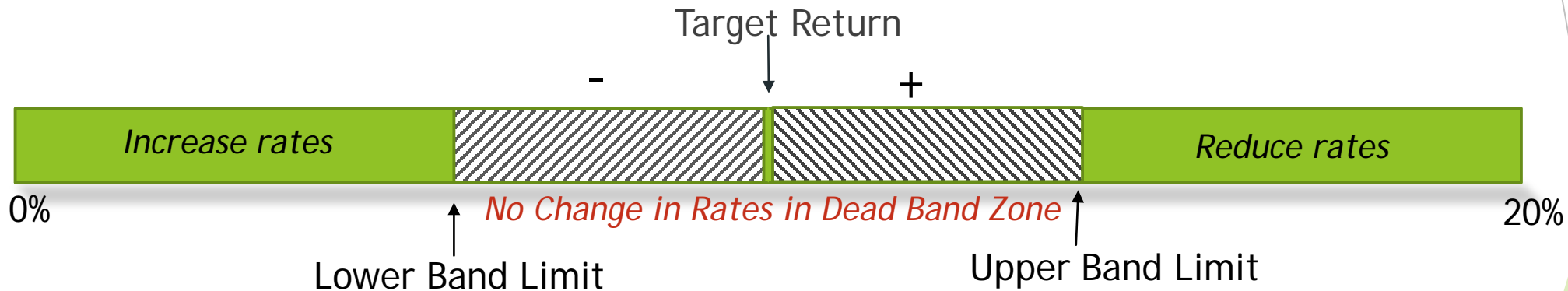
Test Year



- ▶ Most use actual data from most recent calendar year (historical test year) with the exception of Mississippi and Oklahoma.
 - ▶ Mississippi also allows use of a projected test year.
 - ▶ Oklahoma designates the calendar year of the filing as the test year. No pro forma adjustments. December operating expenses are annualized.
- ▶ Historical test years usually allow for pro forma plant additions plus known and measurable changes.

How the Mechanism Works

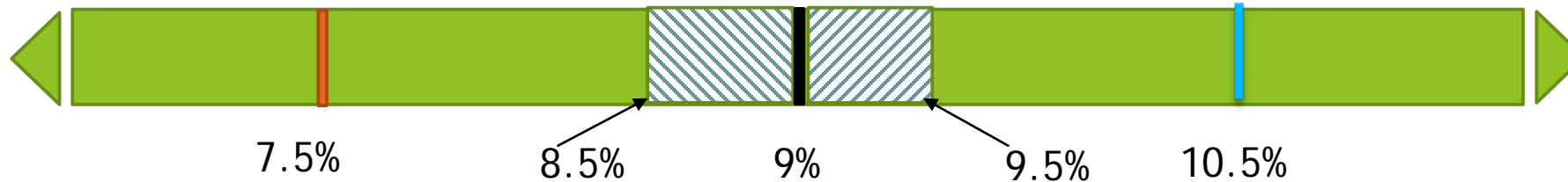
For 5 out of 7 states, an adjustment to base rates is made only if the earned return measure (either ROE, weighted ROE or overall rate or return on rate base) falls outside a pre-determined dead band around a target/benchmark return measure. Rates are increased (or decreased) to achieve the target return.



In Illinois, however, rates are increased (or decreased) to bring the return measure to either the lower band limit (if company under earned) or to the upper band limit (if company over earned). Thus, companies keep the gains or losses within the dead band. In Mississippi... it's more complicated!

Dead Band Example

Assume target return is ROE of 9% and dead band is +/- 50 basis points:



If earned ROE is 7.5%, then rates are increased to produce 1.5% (9% target - 7.5%) incremental change in ROE.

If earned ROE is 10.5%, then rates are decreased to produce -1.5% (10.5% - 9% target) incremental change in ROE. No rate change within the band.

In Illinois, however, rates will change even if earned returns fall within the dead band. Under the 7.5% earned return scenario, rates would be adjusted further by 1%, which is the difference between 8.5% (lower band limit) and 7.5%.

And under the 10.5% earned return scenario, rates would be adjusted further by a -1% (9.5% upper band limit - 10.5%).

Base Rate Adjustments

	How the Mechanism Works	Caps/Floors
AL	<ul style="list-style-type: none"> Actual weighted ROE (common equity ratio x ROE) compared to 5.98% target weighted ROE. Actual weighted ROE dead band is <5.75% or >6.21%. Target weighted ROE = 5.98%. Performance-based adder of 0.07% if utility has an "A" credit rating and is in top third of most recent customer value benchmark survey. 	<ul style="list-style-type: none"> Rate increase in any two consecutive years must not exceed 4%. No single year increase can exceed 5%.
AR	<ul style="list-style-type: none"> Earned ROE compared to target ROE approved by Commission in utility's last rate case. ROE dead band of plus/minus 50 basis points from target ROE. Rate adjustment based on difference from target ROE, multiplied by common equity portion of rate base and gross conversion factor. 	<ul style="list-style-type: none"> Total revenue increase or decrease not to exceed 4% for each rate class from preceding 12 calendar months.
IL	<ul style="list-style-type: none"> Revenue requirement (RR) based on most recent FERC Form 1 used to set new rates for the next year. FR case also includes a <u>reconciliation</u> of test year RR approved in last FR case to actual RR using actual costs for that past year. Reconciliation refund/surcharge charged in next calendar year. Target ROE = 580 basis points + average of prior year's monthly US T-Bond yields. ROE Collar: 50 basis points above or below target ROE. ROE penalties capped to a total of 30 to 38 basis points for failure to meet 8 performance metrics. 	<ul style="list-style-type: none"> Average annual rate increase in the first three years of the law's operation should not exceed 2.5%

Base Rate Adjustments (continued)

	How the Mechanism Works	Caps/Floors
MS	<ul style="list-style-type: none"> Earned return on rate base (RORB) for prior year compared to the "Range of No Change." The latter is the benchmark RORB (BRORB) plus or minus adjustments for company performance as measured by customer price, satisfaction and service reliability. RORB dead band of plus/minus 50 basis points. BRORB = target overall rate of return approved by Commission. "Look Back" provision - Annual comparison each year after the FR case. Compares BROB to company earned RORB for that year. Difference is refunded or charged to ratepayers. 	<ul style="list-style-type: none"> No rate change if adjustment is less than \$250,000 or > than 4% increase in annual aggregate retail revenues. Rate changes less than 2% automatically go into effect in first billing cycle of February.
OK	<ul style="list-style-type: none"> Earned ROE compared to a benchmark ROE. ROE dead band of plus/minus 50 basis points. (Same as AR and SC) When earned ROE exceeds the ROE upper band limit, the excess earnings is shared by customers (75%) and the company (25%). Program has separate energy efficiency feature with a utility incentive that can increase rates. 	<ul style="list-style-type: none"> No rate change if adjustment is less than \$250,000.
SC	<ul style="list-style-type: none"> Earned ROE compared to allowed ROE at the time the utility applies for formula rates. ROE dead band of plus/minus 50 basis points from allowed ROE. (Same as OK and AR) 	
LA	<ul style="list-style-type: none"> Earned ROE compared to target ROE approved by Commission. For gas, earned ROE calculated using a benchmark O&M previously established by Commission. ROE dead band of plus/minus 50 basis points (electric) or 80 basis points (gas). Sharing band at given levels for some companies. 	

In summary...

- ❖ With exception of IL, rates are adjusted based on a comparison of an earned return measure to a target or benchmark return measure.
 - ❖ All have a ROE or ROR dead-band that determine if there is to be a change in rates.
 - ❖ In contrast, IL rates change annually. The ROE collar serves as a further adjustment (+/-) to that rate change.
- ❖ 4 have a performance-based component (AL, IL, MS, OK).
- ❖ 4 have a rate cap and 2 have a floor.
- ❖ 2 have some type of sharing excess returns between shareholders and ratepayers (LA and MS).
- ❖ 2 have a type of reconciliation after the formula rate case (IL and MS).

How is it Working?

Residential Average Price of Electricity		
	<u>Jun-17</u>	<u>Jun-16</u>
New England	19.37	18.9
Middle Atlantic	16.49	15.98
East North Central	13.49	13.02
Illinois	12.95	12.2
West North Central	13.36	12.75
South Atlantic	12.2	11.84
East South Central	11.47	10.93
Alabama	12.79	12.16
Mississippi	11.4	10.6
West South Central	10.93	10.54
Arkansas	10.73	10.31
Louisiana	10.19	8.96

Source: EIA Table 5.6.A Avg Price of Electricity to Ultimate Customers by End Use Sector, August 24, 2017