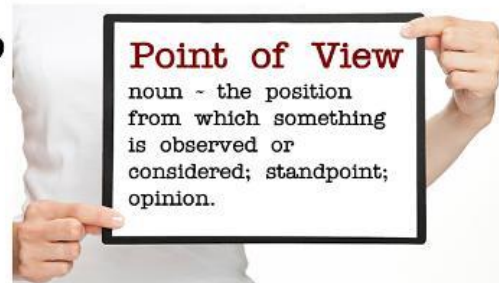




The Financial Research Institute **UPDATE!**

POV



Sponsored by **Chairman Robert Kenney**

Missouri Public Service Commission

Public Utility Regulation in the Twenty-First Century

Public utility regulation began in Missouri 100 years ago last year. The basic premise for economic regulation is that public utilities, by virtue of high capital costs and economies of scale, are natural monopolies. In the absence of competition, a monopoly enterprise will potentially charge monopoly prices, possibly decrease quality of service to increase margins, and otherwise behave in an anti-competitive manner. Enter the regulatory compact. In exchange for a grant of an exclusive service territory, utilities are obligated to provide service to all on a non-discriminatory basis; and they agree to be



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economically regulated. That same compact requires state commissions to allow the utility a reasonable opportunity to earn a fair rate of return. Rates are to be just and reasonable; just and reasonable to both the consumer and the provider.

Fast forward 100 years and we are witnessing changes the likes of which Edison and Tesla could not have imagined. We are faced with challenges and opportunities the likes of which many working in this industry could not have imagined ten or fifteen years ago. But has this basic compact changed? Are we witnessing such a dramatic change in how energy is generated, distributed, transmitted and consumed, that the regulatory model, the very relationship between utilities and regulators needs to change? Yes and no.

Technological advances are allowing for the greater deployment of distributed generation resources. In responding to the challenges and opportunities presented by greater deployment of distributed generation, it is important to examine both the costs and benefits of distributed generation.

Greater deployment of solar distributed generation has the potential to displace the need for new costly generation; it has the potential to reduce wear and tear on the existing transmission and distribution assets; it has the potential to assist consumers in lowering their utility bills; and it has the potential to reduce carbon emissions. All of these are positive opportunities that add value to the transmission and distribution systems. But the wide scale deployment of distributed generation has the potential to upset the traditional utility business model and to result in cost shifting. In other words those that are able to take advantage of installing a solar electric generating system on their roof may end up shifting their share of other utility costs to consumers who do not have distributed generation.

Environmental regulations are also creating significant challenges for public utilities and increasing the job duties for public utility regulators. Recently, the EPA announced plans to implement rules regulating greenhouse gases for new and existing sources under Sections 111(b) and 111 (d) of the Clean Air Act.

The goal of reducing greenhouse gases from existing sources presents real challenges for states like Missouri that derive upwards of 80% of our generation from coal fired power plants. Under Section 111 (d) the EPA is to issue guidelines, while the states are to craft state implementation plans with performance standards and enforcement mechanisms. Traditionally, the crafting of state implementation plans falls to the state air regulators. But there's a role for state public utility commissions to play in this process as well.

Public policy mandates, distributed generation, increased gas production and lower gas prices, environmental regulation, are all creating challenges and opportunities; all placing additional pressures on utilities and regulators alike. State Commissions are most assuredly

assuming more responsibility than was the case fifteen or twenty years ago.

An additional component that I think is implicated in all of the challenges and opportunities we're facing is the need for broad consumer education and outreach efforts. Here, how we communicate with the public requires modernization. In Missouri, we have taken steps forward in that regard.

We have been actively working to increase our community outreach and community education efforts. We have created a speakers' bureau, created a dedicated position tasked with increasing community outreach, partnered with community organizations, and enhanced our communications with civic organizations and media outlets.

Why is this community outreach important? Because we're asking consumers to consume energy differently. Whether it's implementation of energy efficiency and demand side measures or the implementation of time of use rates, we're asking for or trying to incent different customer behavior. As the state agency charged with ensuring safe, adequate and reliable delivery of utility services at just and reasonable rates, we are charged with ensuring customers receive these services and that utilities have the financial integrity to provide these services. We're uniquely positioned, by virtue of our specialized knowledge and our possession of the public trust and our mandate to act in the public interest, to be honest educators of the public.

We are in an era of rapid technological changes that are dramatically affecting our industry and, as a result, public utility regulation. Gone are the days in which we are solely deciding rate cases. This is, of course, still our core function. But more is demanded of us. We are increasingly called on to be educators, conveners, problem solvers, as well as economic regulators. Recognizing this, it is incumbent on public utility regulators to embrace these challenges and seize the opportunities that are presented.

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About the FRI

The Financial Research Institute (FRI) was established in 1988 within the Robert J. Trulaske, Sr. College of Business at the University of Missouri to promote education, research and service across various areas of finance. Today, the FRI, through its public utility division, provides a neutral environment for stakeholders in the regulated public utility industry to come together to examine, understand and debate current issues relating to public utility policy.

Please visit www.fri.missouri.edu to learn more about the institute.