

**STATE OF MISSOURI
PUBLIC SERVICE COMMISSION**

At a session of the Public Service Commission held at its office in Jefferson City on the 6th day of December, 2016.

In the Matter of a Working Case to)
Consider Policies to Improve)
Electric Utility Regulation)

File No. EW-2016-0313

**A REPORT REGARDING POLICIES TO IMPROVE
ELECTRIC UTILITY REGULATION**

Issue Date: December 6, 2016

For over a decade, Missouri investor-owned utilities (IOUs) have proposed legislation seeking to significantly alter the way the Public Service Commission sets utility rates. The breadth of the legislation and specific mechanisms proposed have varied significantly. However, each legislative effort has been primarily focused on the following contention: Missouri’s regulatory framework creates regulatory lag effectively precluding utilities from earning their authorized return and disincentivizing needed capital investment.

Both residential and commercial consumer groups have successfully opposed each past legislative attempt, with their arguments following two general themes. First, they have contended that there was insufficient evidence supporting the need to dramatically change the current regulatory structure. Second, they have argued that each of those past legislative proposals was too far reaching, shifted too much risk to the rate payers, would result in excessive rate increases, and precluded meaningful Commission review. Last session witnessed the latest chapter in this saga with the filing, debate and ultimate demise of Senate Bill 1028.

With the various stakeholder groups appearing to be at an uncommunicative impasse, the Commission issued an Order on June 8, 2016, opening a working docket to gather information and facilitate a productive dialogue between all interested stakeholders and their technical experts. After receiving extensive written comments and convening a well-attended workshop, the Commission's technical staff (Staff) submitted to the Commission on October 17, 2016, a report describing and evaluating stakeholder suggestions and offering its analysis as to whether there is a need for, and if so, the scope of, any legislative reform (Staff Report)¹.

In the Staff Report, Staff acknowledges that utilities are not currently allowed to earn a return on or recover amounts invested in infrastructure until the conclusion of the rate case following the date such plant is put in service. This can create lag between when a utility makes an investment and when it begins to recover that investment. Staff concluded that, although regulatory lag and utility earnings have not been a serious problem to date, minor modifications to the current regulatory structure may be necessary in the future to encourage significant additional investment in grid modernization. Such modifications may be particularly necessary if customer usage continues to remain flat or decline.

Based upon the information and analysis provided in the workshop, the Commission recognizes that at least some utilities would like to automate their electric grids using modern technologies to adapt to changing customer needs. For instance, as part of its information filed in the workshop, Ameren Missouri identified its desire to invest in grid modernization by upgrading its distribution network to allow for automating the identification of repair needs and power restoration. In addition, Ameren Missouri seeks to replace its

¹ Staff Report filed October 17, 2016, in Missouri Public Service Commission File No. EW-2016-0313.

out-of-date meters with smart meters that provide customers modern service options that would facilitate much greater penetration of energy efficiency programs as well as peak load management programs.² Ameren Missouri further stated utilization of energy efficiency and load management programs will be critical as it retires more baseload generating units and works to minimize the need to construct additional large energy centers.³ However, Ameren Missouri, KCP&L, and other utilities contend that regulatory lag disincentivizes such investment.

While the potential benefits of such modernization would always have to be weighed against its cost, the Staff Report identified the following potential benefits: the ability to remotely disconnect/reconnect customers, the potential to resolve service issues more quickly, and the potential to reduce the duration of power outages, all without the need to send a service technician. Staff further noted that all of these factors could reduce utility costs that are ultimately paid by the ratepayers.⁴

The Commission generally agrees with and supports the analysis, conclusions and recommendations presented in the Staff Report. The Commission also recognizes the General Assembly may determine that it should be the policy of this state to encourage utility investment in grid modernization, enacting legislation to encourage such investment. If the General Assembly makes such a determination, then based upon the information and analysis obtained in the working docket, the Commission recommends the General Assembly consider the four principles identified below in drafting any legislative proposal.⁵

² The Critical Need to Replace Aging Electric Infrastructure and Build a Smarter and More Efficient Grid to Meet Customers' Needs and Expectations, filed by Ameren Missouri in Missouri Public Service Commission File No. EW-2016-0313.

³ Id.

⁴ Staff Report, pages 26-27.

⁵ Nothing in this report constitutes an endorsement of, or opposition to, any specific legislation.

1. Missouri's current regulatory structure has functioned very effectively for over a century, and there is no need for a massive, radical overhaul.

Over the last one hundred years, Missourians have enjoyed reliable, high quality utility services at comparably low rates,⁶ and Missouri IOUs have enjoyed reasonable profits. Further, as set out in the Staff Report⁷ and in the Initial Comments of the Midwest Energy Consumers' Group,⁸ Missouri IOUs have not only had stock prices that performed well and experienced reasonable profits, but have enjoyed a favorable regulatory environment compared to other states, and maintained higher credit ratings than utilities in most neighboring states.

Further, Missouri's regulatory structure has evolved significantly and effectively over time to respond to changes in circumstances affecting Missouri utilities. For example, the use of a true historic test-year was modified to allow for normalization of various rate analysis factors, such as atypical test year weather. The modern/modified historic test year rate case also now includes processes to update and true-up expense items well past the end of the formal test year. Additionally, past narrowly tailored legislative changes have afforded the Commission additional mechanisms to provide utilities relief, when appropriate, from volatility in certain classes of costs or costs associated with complying with legislative mandates, such as fuel adjustment clauses, RESRAM⁹, MEEIA¹⁰,

⁶ According to the U.S. Energy Information Administration, the average residential rate in Missouri is 10.99 cents/kWh. This places Missouri 16th in the nation for lowest electric rates. Table 5.6b, Electric Monthly February 2016, with data through December 2015.

⁷ Staff Report, pages 13-14

⁸ Filed July 11, 2016, in Missouri Public Service Commission File No. EW-2016-0313

⁹ RESRAM, Renewable Energy Standard Rate Adjustment Mechanisms (add cite)

¹⁰ MEEIA, the Missouri Energy Efficiency Investment Act (add cite).

ECAM¹¹, etc. The legislation authorizing fuel adjustment clauses, in particular, was an excellent example of legislation directly aimed at a very specific need, which authorized the Commission and stakeholders to design an effective mechanism to address that need.

2. Any new mechanism must not impede the Commission's authority or ability to meet its statutory obligations to set just and reasonable rates while balancing the interests¹² of utilities and their customers.

The use of a formula rate process or guaranteed revenue requirement could limit if not eliminate utility motivation to spend ratepayers' money prudently. Under any new or modified mechanism, the Commission must retain its authority to determine the prudence of utility expenditures, including capital projects, and determine each utility's appropriate rate of return based upon all evidence presented, including market conditions. To be able to make such determinations, the Commission must also retain the authority to review and audit the books and records of utilities and to make appropriate adjustments and disallowances to those records for purposes of rate-making.

3. Any modification of the current regulatory structure should be narrowly tailored.

As with past modifications, any modification of the current regulatory structure should be narrowly tailored to address specific challenges while maintaining the integrity of the regulatory process. For instance, if there is a particular category of investment the General Assembly wants to encourage, such as grid modernization,

¹¹ ECAM, Environmental Cost Adjustment Mechanism (add cite)

¹² The Commission "is charged with considering and protecting the interests of the general public as well as the customers and investors of a regulated utility. It must balance those interests on a statewide basis, not merely considering a particular utility's operating area in isolation." *State ex rel. Cass Cty. v. Pub. Serv. Comm'n*, 259 S.W.3d 544, 549 (Mo. Ct. App. 2008).

it could enact legislation incentivizing such investment. Any regulatory modification that goes beyond addressing the actual challenges faced could easily result in unintended consequences.

4. As with the use of other modified rate mechanisms, a utility's use of any new mechanism must be contingent upon Commission review and authorization.

The Commission is statutorily required to balance interests and does so based upon the specific circumstances of each utility and any interested stakeholders. As with the fuel adjustment clause mechanism authorized by the General Assembly in 386 266.4 RSMo., the Commission should have the authority, after a full hearing in the context of a general rate proceeding, to evaluate and then approve, modify, or reject a utility's request to utilize an alternate rate mechanism based upon that utility's specific circumstances, including market conditions, at the time the request is made. For instance, utilities are only authorized to offer energy efficiency programs through MEEIA that meet specific requirements and have been approved by the Commission pursuant to Section 393.1075.4 RSMo. Utilities must propose portfolios of programs and demonstrate to the Commission and other stakeholders that those portfolios meet the policy goals the General Assembly created.

Similarly, if the General Assembly determines that mechanisms such as performance metrics or preliminary determinations of decisional prudence are necessary to incentivize utilities' investment in grid modernization infrastructure, these mechanisms should be implemented by the Commission as part of a case. In such cases, requests are thoroughly analyzed and refined by all interested parties,

and disagreements that cannot be resolved between competing interests are brought to the Commission for a final resolution. It would be necessary to take care that a utility is not rewarded for performance that is of the type and quality it has a duty to provide with or without incentives. Furthermore, this type of collaboration and review would act as a safeguard against performance metric designs that begin to operate as incentives for unnecessary or inefficient investment. Through this process, the Commission can fully evaluate each utility's circumstances at the time a request is made while also considering the evolving and varied interests of the public at the same time.

As it concludes this process, the Commission would like to thank its Staff and all other stakeholders who contributed their significant expertise and diverse perspectives through comments in the docket and participation in the workshop. While the Commission will continue to offer its subject matter expertise to policy makers as requested, with the filing of this report, this file may be closed.

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BY THE COMMISSION

A handwritten signature in black ink that reads "Morris L. Woodruff".

Morris L. Woodruff
Secretary

Hall, Chm., Stoll, Kenney, and Rupp, CC., concur;
Coleman, C., absent.