October 25, 2016
Senate Interim Committee
Summary of Staff's Report to the Missouri Public Service Commission

Members of the Committee, I am Natelle Dietrich, Public Service Commission Staff Director, and I am happy to speak to you again today to summarize Staff's Report in the working case the Commission opened in June to consider policies to improve electric utility regulation in Missouri. In its docket, the Commission invited interested stakeholders to submit suggestions for policy changes.

On October 17, the Commission Staff submitted a report to the Commission describing and evaluating the submitted suggestions, and offering its recommendations for any actions to be taken by the Commission. The members of the Committee should have received a copy of the report around October 17.

In comments, the utilities allege there is a problem with Missouri's existing regulatory framework, which sets rates for future periods based on historical data creating regulatory lag, "often spanning a period of years". Consumer groups claim that overarching metrics indicate the current regulatory framework is working, and regulators and legislators should be hesitant in making sweeping changes. In Staff's opinion, much of the utilities' concern appears to be related to whether the electric utility will earn its authorized return, and how that affects management decisions to invest in infrastructure beyond what is necessary to provide safe and adequate service.

Through the working docket process, Staff asked the questions:

1. Is there a problem that needs to be addressed?
2. What investments are you (the utility) not able to make under the current regulatory environment that you would be able to make if there was a change in ratemaking practices? and,
3. If the decision to make investment depends on the extent of the regulatory change, please provide information as to investments that will be made under various regulatory environments such as performance-based rates, shortened rate case timing, an electric ISRS.

In preparing the report, Staff reviewed all comments submitted to the docket, held a workshop to seek additional input and clarification, reviewed a number of publications, and met with utility representatives, including a meeting with Ameren Illinois. While Staff is not convinced there is a problem with the current regulatory environment to the extent raised by the utilities, the comments suggest some degree of policy or legislative reform could be beneficial to the Missouri regulatory process. As I will explain, in the report Staff does not recommend sweeping legislative changes, but recommends or does not oppose reforms that are largely within the Commission's current statutory authority.

So - Is there a problem?

The extent of the "problem" depends on how one views the information presented. For instance, one cannot just consider investment costs or consumer benefits, but must also include off-sets for things such as reduction in costs due to automated processes or efficiencies gained from new technologies. As an example, during the meeting with Ameren Illinois it was presented that advanced metering infrastructure or AMI will allow Ameren Illinois to provide same day service, remotely disconnect/reconnect customers, allow Contact Center Representatives to "ping" a meter while on the phone with a customer to potentially resolve issues, and implement outage filtering and analytics. All of these automated processes will reduce the need to send a service technician to site, and should ultimately result in cost reductions that will need to be considered when determining the value of the investment.

Staff met with Ameren Missouri and Ameren Illinois to get a better understanding of Ameren Missouri's investment needs, but also to understand the improvements that are often touted as a result of Illinois legislation. But – one cannot easily compare Illinois and Missouri. What became clear from the tour – Illinois has a different infrastructure system design, and has had issues with reliability that Missouri does not have. Missouri is already there. For instance, Missouri already has automated meters - AMR and some 2-way advanced metering infrastructure - AMI.

Utility Name	# AMR	# AMI	# conventional	Total
Ameren Missouri	1,196,283	0	13,792	1,210,075
Ameren Illinois	664,150	249,548	309,624	1,223,322
KCP&L	1,784	273,109	11,174	286,067
GMO	456	14,032	299,501	313,989

Therefore, regulatory changes should incentivize grid modernization and replacement of aging infrastructure – not incentivize what is already being completed under the current regulatory environment.

Switching to regulatory lag - In Staff's opinion, regulatory lag is not inherently bad. There is a difference between the utility "losing money" and not earning its authorized return. Utility comments suggest the electric utilities have been able to invest what is necessary for the provision of safe and reliable service, but may not be able to invest in aging infrastructure or infrastructure to meet Missouri's future energy needs without "a realistic opportunity" to earn their authorized return.

<u>Western District Court of Appeals (9/6/16) – Regulatory Lag</u>

KCPL argued at the Western District Court of Appeals that, "the PSC's reliance on historical data will fail to reflect KCPL's current expenses when the new rates take effect, which KCPL claims will be higher than historical costs indicate due to a number factors, a phenomenon called 'regulatory lag.'" The Court's September 2016 Opinion stated, "[A]lthough KCPL complains that the historical test-year model with a true-up period does not adequately take into account regulatory lag, the PSC has adapted its methodology to attempt to account for regulatory lag. The true-up period established by the PSC was designed to remediate some of the negative effects of regulatory lag by taking into account known and measurable subsequent or future changes to KCPL's expenses."

"The best way to account for regulatory lag is a question of methodology and ***is best addressed by the expertise of the PSC***, which this Court will not second-guess."

Other States

Much like the previous Senate Interim Committee hearings, Staff also reviewed the regulatory environment in other states. Some observations include:

First, there is no clear consensus among the state jurisdictions regarding any of the proposed ratemaking approaches. Based upon Staff's review, none of the specific approaches advocated by the utilities in Missouri are routinely used in a majority of the states.

Second, where the initiatives have been adopted, usually it has been on a more limited basis than the broad application often advocated for in the comments and in the workshop. As examples, when either ISRS-type plant rate recovery mechanisms or construction work in process (CWIP) in rate base is allowed in other jurisdictions, the treatment is usually applicable only to defined subsets of plant investment (for example, transmission plant additions or environmental additions), and not for all plant additions.

Third, while the utilities have identified the historical cost basis for setting rates used in Missouri as the root cause of their alleged earnings difficulties, a distinct majority of the states use historical cost ratemaking as opposed to forecasted test year approaches.

Finally, the form of formula ratemaking that provides for automatic upward and downward rate adjustments to allow the utility to earn at or near a "target" rate of return is currently used by only five states for electric utilities (Alabama, Arkansas, Illinois, Louisiana and Mississippi). The only states that have implemented this type of ratemaking in recent years are Arkansas and Illinois, with Arkansas using the ***rate case process*** to set the formulaic parameters, and Illinois including ***specific statutory conditions*** related to jobs and investments.

Staff's Recommendations

Based on Staff's review of all the information submitted in the docket, in its report, Staff recommends:

1. **Any reform give Commission discretion ("tools in tool box") – In other words, allow the parties to recommend a ratemaking proposal and the Commission to develop approaches based on such things as:**

- Different utilities have different needs – one size does not fit all
- New technologies
- Environmental mandates
- Changing circumstances
- Facilitate replacing of aging infrastructure and incentivize grid modernization

2. **Any reform designed to encourage grid automation or infrastructure replacement should include a requirement to submit, for Commission approval, a 5-year investment plan, which includes annual progress updates.**
3. **The Commission should retain the ability to review and audit the books and records of utilities operating under its jurisdiction.**

4. **If the risk faced by Missouri utilities is materially changed, the change in risk should be taken into account when setting the utilities' authorized return.**
5. **Any changes preserve current incentives for utilities to operate efficiently.**
6. **Any changes preserve matching in a utility's revenue, expense and rate base values.**

<u>Specific proposals for reform</u>

In the report, Staff notes it is not opposed to the following specific proposals for reform:

<u>a.</u> Shortened rate case processing as long as all parties continue to be afforded due process, and the ability of the Commission to perform a thorough review and audit of the books and records of utilities operating under its jurisdiction as part of the rate review process is preserved.

<u>b.</u> Trackers/Riders considered on a case-by-case basis based on all relevant evidence.

<u>c.</u> Interim rate increases.

<u>d.</u> An electric ISRS that is implemented similar to what is expressly allowed for water and natural gas utilities.

e. An electric rate case adjustment proceeding that includes the traditional 11-month rate case every 3 years, with an annual 7-month rate case adjustment to update the revenue requirement and rate base, and includes certain other consumer protections.

f. A decisional pre-approval process with post-construction review of costs and timeline to complete the project.

g. A grid modernization mechanism to allow timely, efficient and prudent cost recovery to utilities for automating and modernizing the grid that also includes performance metrics and milestones, an investment floor and ceiling.

There were also several more targeted proposals for reforming the Missouri Energy Efficiency Act, the renewable energy standards, low income rates, and workforce development, to name a few. In the interest of time, those proposals will not be summarized today, but we would be happy to answer questions on any of them, what I have summarized or other aspects of the report. According to the Commission's order opening the working docket, the Commission is expected to issue a final report based on Staff's analysis by December 1.