STAFF PERSPECTIVE ON REGULATORY LAG/OUTLINE

SEPTEMBER 13, 2016

CASE NO. EW-2016-0313

Wide Variety of Views on Regulatory Lag Submitted in Comments

Regulatory lag is “good” – provides incentives for utility efficiency; allows time for thorough audit of utility costs, and ensures all costs are subject to review before being charged to customers in rates

Regulatory lag is “bad” – impairs financial health of utilities; may cause increase in borrowing costs; may forestall capital investment that would be in the public interest

Both viewpoints are correct, but under different conditions – A regulatory structure may feature either “too much” or “too little” regulatory lag

A key point is that some amount of regulatory lag is inevitable under all regulatory formats/approaches –What is the right amount?

Actual Incurrence of Regulatory Lag in Missouri

Missouri has an eleven-month operation-of-law period, but utilities typically do not face a full eleven months of regulatory lag concerning their rate recovery requests

Utilities can “time” their rate case filings to cover events that will occur in the near future (plant additions, payroll increases) as of the time of the rate filing

“True-up” update processes within rate cases mean that rate cases can take into account material cost drivers that occur up to approximately five months prior to when rates take into effect

In most recent rate cases, the majority of the rate increase request applies to costs that have not been incurred at the time the rate application is filed

Some major categories of costs are effectively subject to little or reduced levels of regulatory lag, such as fuel/purchased power expense, pensions/OPEBs benefits expenses, energy efficiency revenue and expense impacts, and renewable energy investment costs

Regulatory Lag as Efficiency Incentive

The reality of regulatory lag provides regulated utilities with the same incentives to hold down their costs that competitive firms face from the discipline of the marketplace

The impact of reduced earnings associated with cost increases is a strong incentive for utilities to keep cost increases to a minimum, and the impact of increased earnings associated with cost decreases is a strong incentive for utilities to attempt to become more productive over time

Due to its incentive impacts, allowing for the potential for some amount of regulatory lag within a ratemaking structure is better than employing a ratemaking approach that seeks to eliminate regulatory lag in entirety or almost in entirety

Overall Assessment of Regulatory Lag/Current Practices

Based upon the available evidence, Staff does not believe that Missouri utilities have, as a whole, systematically under-earned in recent years due to regulatory lag

Regardless, Staff is not opposed to consideration of possible modifications to the current Missouri ratemaking process in order to reduce regulatory lag from current levels, as long as certain principles are followed

In this regard, Staff supports measures allowing the Commission an enhanced ability to use of a variety of tools as part of regulatory lag reduction efforts; these tools potentially could include some or all of the different ratemaking options to be discussed later today

Overall Assessment of Regulatory Lag/Plant Modernization

Staff agrees that regulatory lag issues should be examined in the context of proposals for increased plant modernization/infrastructure replacement initiatives that may go beyond adherence to the traditional “safe and adequate” service standard

However, Staff recommends that more limited ratemaking options be explored, in addition to proposals for a total “overhaul” of the current regulatory system, in order to accommodate these initiatives

Suggested Principles to Guide Policy Decisions Regarding Regulatory Lag

The ability of the Missouri Commission to review and audit the books and records of utilities operating under its jurisdiction should be preserved.

If regulatory lag is perceived to be a problem, the focus should be on efforts to actually reduce the amount of regulatory lag, and not merely shift the economic impact of regulatory lag from the utilities to customers

Any changes in policy should preserve current incentives for utilities to operate efficiently, and not serve to effectively guarantee the utilities a particular return or profit level

As much as possible, any ratemaking changes to reduce the impact of regulatory lag should preserve the appropriate matching in time of a utility's revenue, expense and rate base values in setting rates

If the risk faced by Missouri utilities is materially changed by enactment of policy initiatives to reduce regulatory lag, this change in risk should be taken into account in setting the utilities' authorized returns