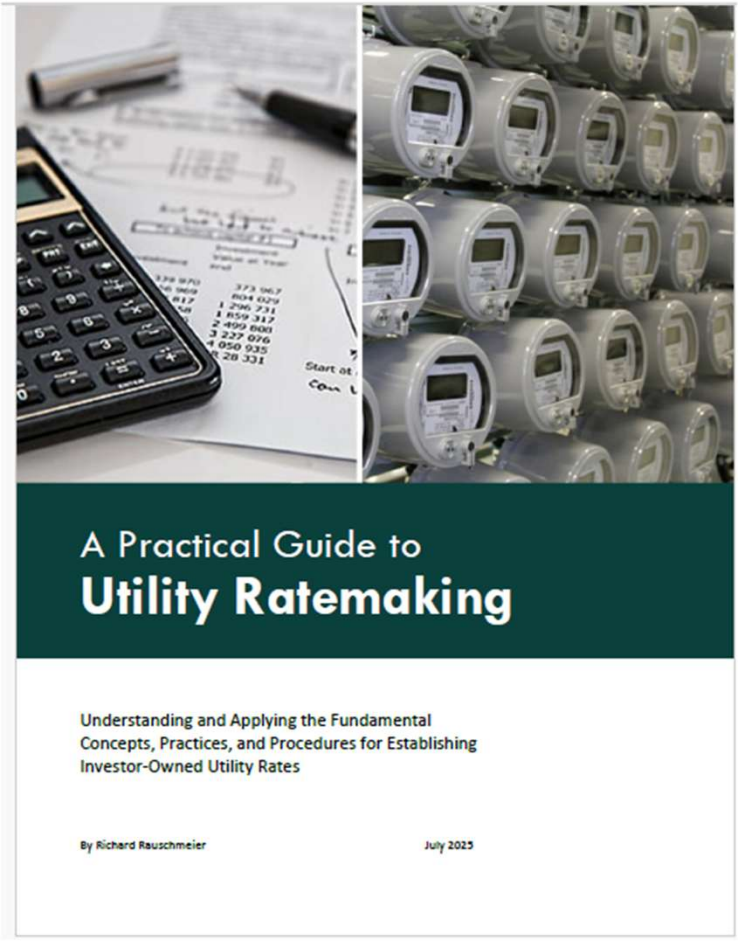
A Practical Guide to Utility Ratemaking

- 130-page Workbook
- +100 Problems & Solutions
- Real Case Studies
- Most Common Errors
- Meets Mandatory Training
- Universal Implementation



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- The Revenue Requirement is what a utility must collect to cover costs and have an opportunity for a reasonable rate of return
- When the Revenue Requirement increases, rates increase (and when the Revenue Requirement decreases rates decrease)
- The Rate of Return determines the Profit a utility will earn
- It is possible to compare a utility's actual Rate of Return with its Authorized Rate of Return (or compare actual Rate Base to authorized Rate Base)
- Lowering a utility's Rate of Return lowers the Revenue Requirement and the rates customers pay (all else being equal)
- Regulatory Accounting Follows Generally Accepted Accounting Principles
- A Test Year must include the period in which new rates will be in effect
- A Future Test Year is required for prospective ratemaking
- Examining more than one issue at a time avoids single-issue ratemaking
- Once approved in rates, removing a capital project from rates is retroactive ratemaking
- Memorandum and Balancing Accounts (i.e. trackers and riders) prevent retroactive ratemaking
- Including a capital project in rates provides the funds necessary for construction
- Removing a proposed project from rates results in a regulatory disallowance
- Utilities require regulatory approval to spend or build projects
- Requiring shareholder profits to be reinvested in utility infrastructure prevents windfall shareholder profits.

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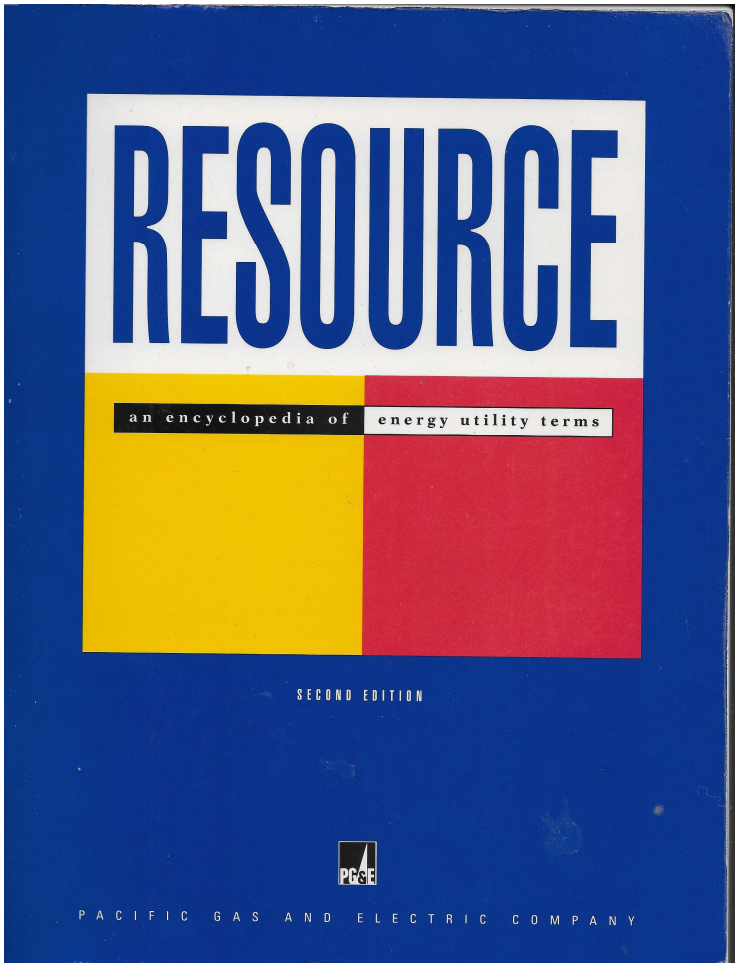
PG&E *Resource*: *An Encyclopedia of Energy Utility Terms*

Revenue Requirement: Total Amount of money a utility must collect from customers to pay all operating and capital costs, including a fair return on investment.



Revenue Requirement is a Budget

A utility can collect **less** than its Revenue Requirement and Exceed its Authorized Profit

A utility can collect **more** than its Revenue Requirement and Fail to make its Authorized Profit

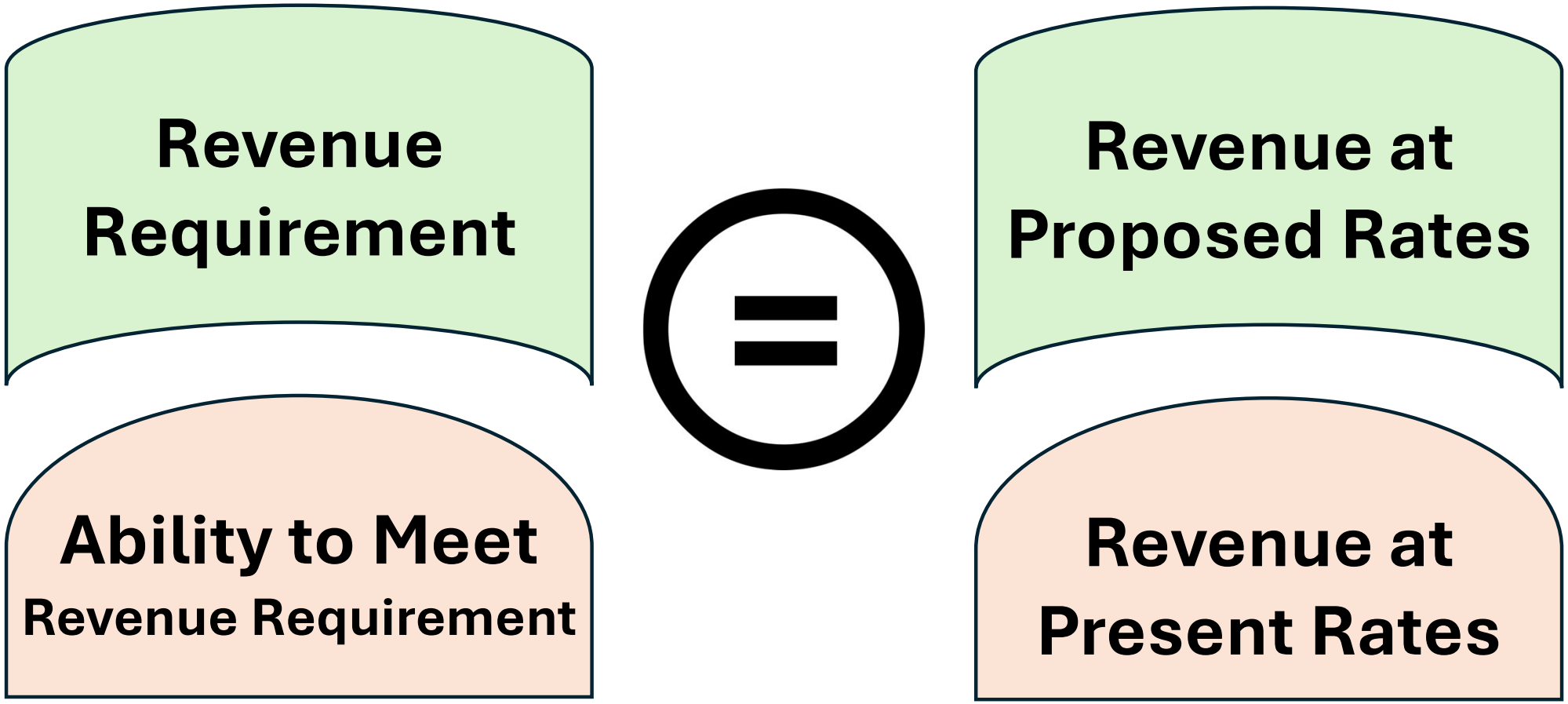
If Revenue Requirement Increases

A. Rates must Increase

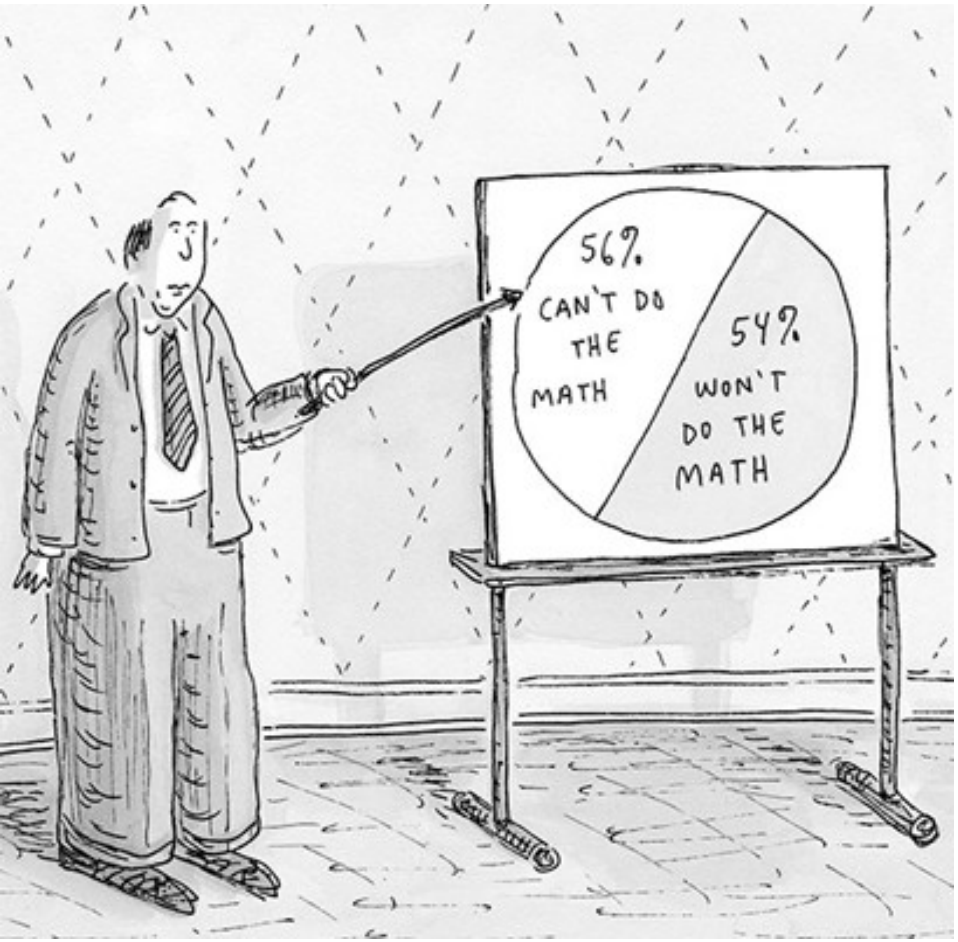
B. Rates must Decrease

C. Don’t Know

To Determine a Rate Change, Need to Know Both…



$$\frac{\text{Revenue at Proposed Rates}}{\text{Revenue at Present Rates}} - 1 \times 100\% = \text{Change in Average System Rates}$$



- Δ Revenue After a Rate Change
- Most commonly communicated
- Not the same as Δ in Average Bill

What Do We Know (or Don't Know)

If and When...	Revenue Requirements Increasing	Revenue Requirements Decreasing
Revenue at Present Rates Increasing	Unknown Rate Change (may be + or -)	Average System Rates Must Decrease (-)
Revenue at Present Rates Decreasing	Average System Rates Must Increase (+)	Unknown Rate Change (may be + or -)

Case Study – A Water Utility's 10% Proposed Rate Change

- Proposed a "10% Rate Increase"
- Revenue Requirement Increasing 10%
- During Drought Consumption had Fallen
- Ability to Meet RevReq Decreasing 20%
- Proposed Rate Change = 30%

Case Study #2 – A Telecom's Misunderstood Rate Change

- Delayed Decision – Interim Rates Authorized
- Final Decision Issued
- Revenue Requirements LESS than Previous
- Company MUST refund all interim rates
- Appellate Court Remands

Regulatory Constructs

- Rate Base x Rate of Return = Net Income
- Necessary for setting rates
- Impossible to compare to actual financials
- ROE is the bridge between Ratemaking & Financials

Example:

Authorized 10% Return on Equity, a 6% cost of debt, and a 50/50 capital structure for an authorized Rate of Return of 8.0%

Calculating the utility's "actual" Rate of Return next year. The result is 7.8% based on actual cost of debt at 5%, the actual capital structure being 60% debt and 40% equity, and an actual 12% return on equity.

"Actual" Rate of Return < Authorized Rate of Return…Increase Customer Rates?

Retroactive Ratemaking in California

- History of asserting memorandum and balancing accounts prevent retroactive ratemaking
- Only necessary to assert if one believes that retroactive ratemaking is unlawful
- Overly convenient to believe one is upholding the law rather than engaging in bad policy
- Recognize when retroactive ratemaking is necessary and explain why it is reasonable

Single-Issue Ratemaking

- Never justifiable or reasonable
- Legal standard of rates providing an opportunity for a reasonable return
- Single Issue Ratemaking = Unknown Opportunity
- Need Revenue, Expense and Capital Investment
- Safeguard when Retroactive Ratemaking occurs

Proceeds from the Gain on Sale

- When / How Does it Occur?
- Who gets Proceeds (ratepayers or shareholders)?
- Policy Determination - often dependent on assets
- California Infrastructure Investment Act
- All proceeds from the sale of assets sold by a water utility must be reinvested for ratepayer benefit.
- Translated: Shareholders keep 100% of the Gain

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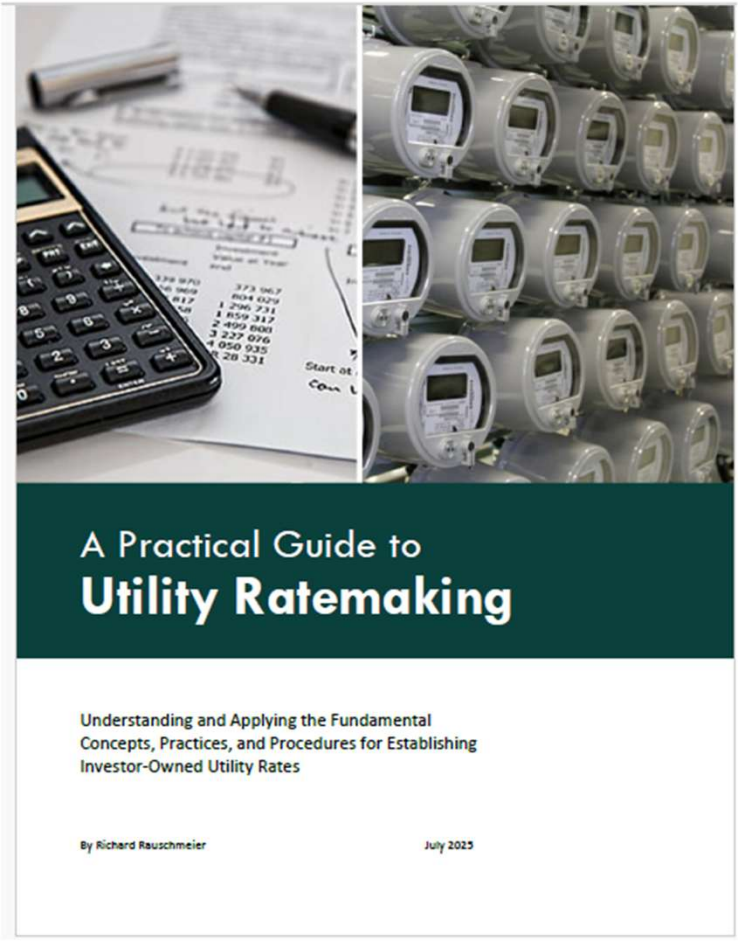

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