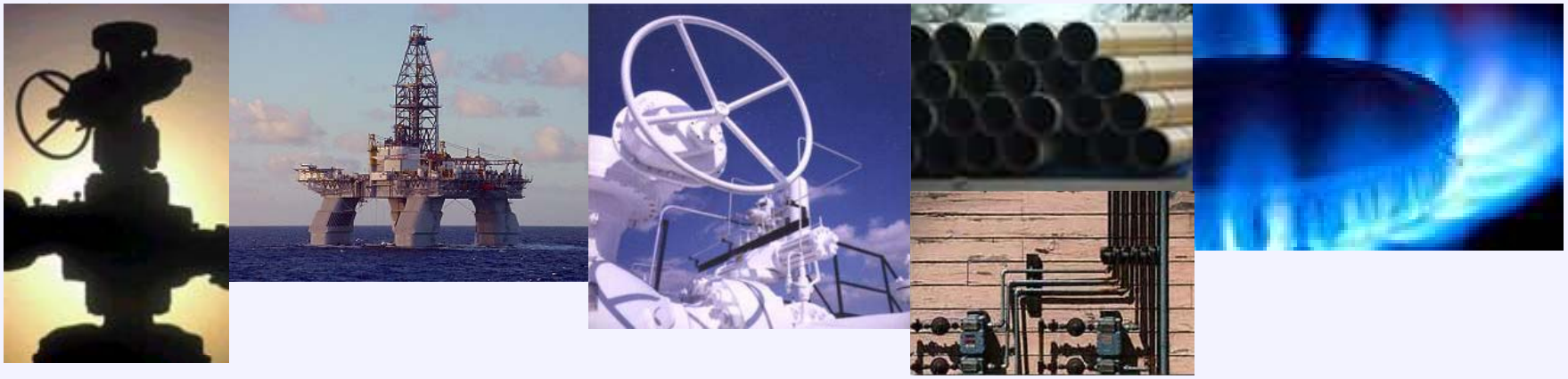

Regulatory and Ratemaking Issues Associated with Cost and Revenue Tracker Mechanisms

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Overview of Topics

- Definition of Tracker Mechanisms
- Commonly-Cited Rationales For Trackers
- Recent Examples
- Tracker Shortcomings
- Questions to Ask in Examining Tracker Proposals
- Conclusions

Tracker Definitions

- Mechanisms that remove cost and/or revenue recovery from base rates to a separate rider or tariff.
- Can be for the collection of new costs not included base rates or true-ups of revenues or expense items from levels that differ from the test year.
- Recovery typically periodic and more frequent than rate cases.
- While mechanisms can include surcharges and credits they should not be automatically considered “symmetrical.”
- Mechanisms originally developed with fuel-cost recovery, but have expanded to a variety of other sales, capital and expense-related changes.

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Tracker Mechanism Examples

Tracker Mechanism	Recovery Type	Purpose
Asset Replacement Riders	Capital	Replace aging or inferior assets.
Inflation Riders	Expense	Inflate costs to match general inflation or other measure.
Asset Development Riders	Capital	Facilitate preferenced assets like baseload generation, smart meters.
Energy Efficiency Riders	Expense	Recover energy efficiency expenses as incurred.
Renewable Energy Riders	Capital	Recovery renewable energy development costs, rebates, and/or PPAs.
Environmental Cost Riders	Capital/Expense	Recovery of capital investment or air emission credits.
Weather Normalization Clauses	Revenue	Recovery of changes in sales due to weather.
Revenue Decoupling	Revenue	Recovery of changes in sales due to other factors.

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Commonly-Cited Rationales for Trackers

Rationale	Driver
Volatile and unknown cost changes.	Recent increases in commodity costs and inflation.
Remove disincentives to purse public policy goals.	Energy efficiency, renewables, fuel diversity.
Required by “Wall Street.”	Capital crisis/recession.
Required to ensure recovery of revenue requirement.	Changes in UPC, climate change, other “exogenous factors.”
Reduce rate cases.	Increase in recent number of rate cases.

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Selected Examples

Tracker Mechanism	States	Utilities
Asset Replacement Riders	AR, KS, MA, NJ, OR	Centerpoint Energy, Atmos, Bay State Gas Company, NJ Natural Gas, Elizabethtown Gas, Northwest Natural
Inflation Riders	MA (proposed), NE (proposed), CA	National Grid (proposed), SourceGas (proposed), Pacific Gas & Electric
Asset Development Riders	FL, IA, MD (proposed)	FPL (nuclear), PEF (nuclear), IA (coal, allowed, not used), MD (smart grid)
Energy Efficiency Riders	FL, UT, NJ, CA	FPL, Questar, PSE&G, JCP&L, Pacific Gas & Electric, SoCal Gas
Renewable Energy Riders	NJ, MA, MI, VA	PSE&G, JCP&L, National Grid, Detroit Edison, Consumers Energy, VA Electric
Environmental Cost Riders	LA., GA, KS, MS	Entergy Gulf States, Georgia Power, Westar, Mississippi Power
Weather Normalization Clauses	AR, IN, KS, MD, NY, TN, UT	Centerpoint, Indiana Gas, Atmos, Aquila, Chesapeake, ConEd, NYSE&G, Rochester, Piedmont, Questar
Revenue Decoupling	CO, IL, MD, NY, NC, OR, WA	PS Colorado, Peoples Gas, Washington Gas, ConEd, Avista, NW Natural

Tracker Expansion

- While some of these mechanisms are somewhat older in implementation (e.g., WNA, revenue decoupling), others are relatively new (asset development, inflation riders), and others are being modified and expanded (energy efficiency, renewables, environmental cost).
- Another recent theme in tracker proposals is the "multiple proposal" approach being pursued by utilities in various regulatory filings (numerous as opposed to individual tracker proposals).
- Increased adoption by some state commissions has led some utilities to refer to these mechanisms as the "new traditional regulation" or "new chapter" in utility regulation.

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Tracker Shortcomings

Practice/Theory	Traditional Approach	Tracker Approach
Inconsistency with regulatory practice: "regulatory compact"	Utilities have traditionally been tasked with proposing projects, developing projects, and incurring the cost to develop projects. Afterwards, the utility must prove that the investment is used and useful and developed a reasonable cost.	Utilities would incur costs for projects often no defined ex ante, and recover the costs of these projects, as they are incurred, in rates. Afterwards, regulators and other parties would be required to show that the investments were not needed and the costs were unreasonable.
Inconsistency with regulatory theory: the role of "asymmetric information" in utility regulation.	Regulated firms know their cost structures better than regulators. Thus, best policy is to use regulatory lag, or incentive regulation (benchmarking) to drive utilities to efficient outcomes.	Regulators can easily determine the reasonableness of all capital investments and their costs within a matter of months and can comfortably adjust rates accordingly.

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Risk Shifting

Risk Type	How it is Shifted to Ratepayers	Potential Consequence
Regulatory Risk	Ratepayers have to prove investments are imprudent rather than utilities proving that they are prudent.	Taken away, or significantly reduced the power of a regulatory disallowance that is long recognized as a powerful regulatory tool in minimizing cost and expense inefficiencies and offsetting potential “A-J” or “X-inefficient” outcomes.
Performance Risk	Ratepayers have to prove that tracker objectives were not met on sometimes illusive (qualitative) cost and investment decisions.	Effectively paying for a service before it has been rendered.
Sales Risk	Ratepayers will make utilities whole for any change in sales regardless of reason (economy, price, weather).	Decoupling revenues from sales is likely to lead to a decoupling of costs from revenues in a regulated cost-based industry.

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Risk Shifting: Rejoinders

- **A common utility response is that "risk shifting" is consumer advocate "code" for a confiscatory "takings."**

  <u>Response:</u> Investors are not promised (guaranteed) a specific level of revenues, a specific return nor are they guaranteed to make whole for inflation or imprudent management actions. Utilities and their shareholders are given a reasonable opportunity (not guarantee) for these returns.

- **A common energy/environmental advocates' response is that "risk shifting" is consumer advocate "code" for insensitivity to clean energy policies.**

  Response: The goal of public utility regulation is to govern the industry in the multi-faceted public interest. Benefiting one aspect of this interest at the expense of the other is counter-productive and inconsistent with economic theory and regulatory practice. No one is arguing "don't pursue clean energy agendas." The argument should be "let's pursue those agendas correctly."

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Conclusions: Hard Questions to Ask in Evaluating Tracker Proposals

- Is the mechanism allowed by law? (revenue neutral?)
- Is the mechanism well-defined?
- Is the mechanism needed and does it address the problem?
- Are there any performance standards, reciprocity provisions, or other reflections of changes in risk?
- Are there any ratepayer protection mechanisms? (caps, bounds, triggers)
- Are there any alternative approaches that are better suited to addressing the problem?

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Questions, Comments, & Discussion

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