

2016 Annual Rate Case Survey

BY PHILLIP CROSS

It is often said that ratemaking is as much art as science. That is particularly true in setting the return on equity component of a utility's revenue requirement.

In this, our annual survey of utility rate cases, we give readers a glimpse into the results of this process as conducted by state utility regulators across the country. The table reports several categories of basic data drawn from electric and natural gas base rate decisions issued during the past year. There is a special emphasis on the rate component that reflects the allowed rate of return on common equity capital.

Figures and statistics tell part of the story. But it is the process of setting a return on equity that is fair to both shareholders and consumers that demonstrates the art and science practiced by regulators.

One case reported here provides a good glimpse at the entire range of issues put before regulators. And how they assess the entire record to settle on a single return on equity figure to use in determining a utility's revenue requirement.

The featured case is a decision by the Michigan Public Service Commission setting electric rates for Consumers Energy Company. The suggested return on equity presented by the witnesses ranged from a low of 9.6 percent to a high of 10.7 percent.

The commission had before it the usual testimony regarding financial modelling, presented in support of each party's estimate of the return on equity required, in order to attract an adequate level of capital.

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Such modelling included proxy group recommendations, stock market performance data, bond rating data, and Treasury bond yield risk premium analyses. However, what was particularly notable was the broad range of more subjective types of evidence that could bear on an investor's decision on whether to purchase utility stock.

The utility and other parties to the case spent considerable effort developing testimony detailing a wide range of seemingly subjective opinions, as to which factors investors think about, when deciding

where to put their money.

Consumers Energy presented technical evidence at the outset to support its request for a return on equity of 10.7 percent. But it also advanced a fail-safe position later in the case, after an administrative law judge had issued a proposed ruling to recommend a lower figure of 10.0 percent.

That fail-safe position asked the commission to recognize that investors would likely expect that the 10.3 percent figure approved by the commission in its most recent rate proceeding would continue in effect.

The utility argued that even though its models showed that investors should want a higher rate, 10.3 percent was still the minimum rate that investors would accept. This, considering the need for revenue given the unusually ambitious and expensive capital improvement program already under way.

Consumers Energy pointed out that it was currently engaged in a capital investment program costing more than seven billion dollars over the period 2015 to 2019, with implications both for risk and capital attraction.

The utility added that if the commission was to drop the return on equity to 10.0 percent, as advocated by the commission staff, and supported by the hearing examiner in the case, it would "send the message to investors that Michigan is a volatile regulatory environment."

Consumers Energy also argued that in order to attract capital at a reasonable cost it needed to maintain its recently improved credit rating. Here, though, various customer groups answered that the improved ratings provided access to lower debt costs and an improved cash position, which would imply a lower return on equity requirement.

And as one opposing witness commented, "It is an odd world" where any reduction in a utility's rate of return or a failure to raise the rate makes the regulatory environment "volatile."

FIG. 1

2015 RATE CASE STUDY

State	Company	Utility Type	Case, Docket or Decision No.	Application Date	Order Date	Test-year End Date	Increase (Decrease) Requested (\$Million)	Increase (Decrease) Granted (\$Million)	Previously Authorized ROE Rate (% - Common Equity)	Newly Authorized ROE Rate (% - Common Equity)
AZ	UNS Electric, Inc.	Electric	75697	5/25/15	8/18/16	12/31/14	22.6 ¹	15.1 ²	9.50	9.50
AR	Entergy Arkansas	Electric	15-015-U	4/24/15	2/23/16	3/31/15	268.5	225.1	9.50	9.75
AR	SourceGas Arkansas, Inc.	Gas	15-011-U	4/1/15	1/28/16	3/31/15	12.6	8.0	9.30	9.40
CO	Public Service Co. of Colorado	Gas	15AL-0135G	3/3/15	2/16/16	12/31/14	109.10	38.4	9.72	9.50
ID	Avista Corp.	Electric	AVU-E-15-05	6/1/15	12/18/15	12/31/14	13.20	1.7 ³	10.50 ⁴	9.50
ID	Avista Corp.	Gas	AVU-G-15-01	6/1/15	12/18/15	12/31/14	3.20	2.5	10.50	9.50
IL	Ameren Illinois	Electric	15-0305 ⁵	4/24/15	12/9/15	12/31/14	109.174	105.78	9.25	9.14
IL	Ameren Illinois	Gas	15-0142	1/23/15	12/9/15	12/31/16	12.62	11.97	9.08	9.60
IL	Commonwealth Edison Co.	Electric	15-0287, 326 PUR4th 107 ⁵	4/15/15	12/10/15	12/31/14	(50.46)	(66.68)	9.25	9.14
IN	Indianapolis Power & Light Co.	Electric	44576, 329 PUR4th 486	12/29/14	3/16/16	6/30/14	67.70	30.8	12.10 ⁶	9.85
IN	Northern Indiana Public Service Co.	Electric	44688	10/1/15	7/18/16	3/31/15	126.6	72.5	10.20	9.975
KS	Atmos Energy Co.	Gas	16-ATMG-079-RTS, 328 PUR4th 275	8/13/15	3/17/16	3/31/15	5.7	2.2	9.10	*
KS	Kansas City Power & Light Co.	Electric	15-KCPE-116-RTS, 324 PUR4th 173	1/2/15	9/10/15	6/30/14	67.3	40.13	9.50	9.30
KS	Westar Energy, Inc.	Electric	15-WSEE-115-RTS	3/2/15	9/24/15	9/30/14	250.9	185.3	10.00	*
LA	Cleco Power LLC	Electric	U-33848 ⁵	10/31/15	8/11/16	6/30/15	N/A	N/A	10.90	10.90
MD	Baltimore Gas & Electric Co.	Electric	Case No. 9406	11/6/15	7/29/16 ⁷	11/30/15	107.3	44.1 ⁷	9.75	9.75
MD	Baltimore Gas & Electric Co.	Gas	Case No. 9406	11/6/15	7/29/16 ⁷	11/30/15	75.80	47.9 ⁷	9.65	9.65
MA	Columbia Gas of Massachusetts	Gas	DPU-15-50	4/16/15	10/7/15	12/31/14	49.7	32.8 ⁸	9.55	9.55
MA	Fitchburg Gas & Electric Light Co.	Electric	DPU 15-80	6/16/15	4/29/16	12/31/14	3.8	2.1	9.70	9.80
MA	Fitchburg Gas & Electric Light Co.	Gas	DPU 15-81	6/16/15	4/29/16	12/31/14	3.0	1.6	9.20	9.80
MA	NSTAR Gas Co.	Gas	D.P.U. 14-150	12/17/14	10/30/15	12/31/13	35.2	15.83	13.00 ⁹	9.80
MI	Consumers Energy	Electric	U-17735, 325 PUR4th 218	12/5/14	11/19/15	5/30/16	163	126	10.30	10.30
MI	Consumers Energy	Gas	U-17882	7/17/15	4/21/16	12/31/16	85	40	10.30	*
MI	DTE Electric Co.	Electric	U-17767	12/19/14	12/11/15	6/30/16	370.0	238.2	10.50	10.30
MI	Michigan Gas Utilities Corp.	Gas	U-17880	6/22/15	12/11/15	12/31/16	6.7	3.4 ³	10.25	9.90
MI	Upper Peninsula Power Co.	Electric	U-17895	9/18/15	9/18/16	12/31/16	6.68	4.65	10.15	10.00

Source: Fortnightly research, Phillip S. Cross

A similar back and forth played out on other issues regarding these four claims:

The utility enjoyed a reduced risk, given the full set of cost trackers and decoupling measures that form part of the ratemaking process in Michigan.

The current historically low interest rates argued for adjustments to return on equity forecasts one way or another. The return on equity awarded by regulators had declined over recent years to levels even lower than the 10.0 percent figure advanced

by the commission staff. And investors might not yet fully recognize or appreciate the relative economic stability prevailing today both in the U.S. and in the state of Michigan.

While the commission did not address each of the individual

FIG. 1

2015 RATE CASE STUDY (CONTINUED)

State	Company	Utility Type	Case, Docket or Decision No.	Application Date	Order Date	Test-year End Date	Increase (Decrease) Requested (\$Million)	Increase (Decrease) Granted (\$Million)	Previously Authorized ROE Rate (% - Common Equity)	Newly Authorized ROE Rate (% - Common Equity)
MN	CenterPoint Energy Minnesota Gas	Gas	G-008/GR-15-424, 330 PUR4th 301	8/3/15	6/3/16	9/30/16	54.1	27.54	9.59	9.49
MS	CenterPoint Energy, Inc.	Gas	12-UN-139	5/1/15	12/3/15	12/31/14	2.51	1.91	9.27	9.53
MS	Mississippi Power Co.	Electric	2015-UN-80	5/15/15	12/3/15	5/31/16	159.0 ¹⁰	126.0 ¹⁰	9.70	9.225
MO	The Empire District Electric Co.	Electric	ER-2016-0023	10/16/15	8/10/16	6/30/15	33.4	20.4	9.75	9.90
MO	Kansas City Power & Light Co.	Electric	ER-2014-0370	10/30/14	9/2/15	3/31/14	120.9	89.7	9.70	9.50
MT	Montana-Dakota Utilities Co.	Electric	D2015.6.51; 7433f	6/25/15	3/25/16	12/31/14	11.7	7.4 ¹¹	10.25	9.50 ¹²
NL	Newfoundland Power Inc.	Electric	P.U. 18 (2016)	10/16/15	6/8/16	12/31/16	24.5 ¹³	11.4 ¹³	8.80	8.50
NJ	Atlantic City Electric Co.	Electric	ER106030252	3/22/16	8/24/16	12/31/15	84.4	45.0 ¹⁴	9.75	9.75
NM	El Paso Electric Co.	Electric	15-00127-UT	5/11/15	6/8/16	12/31/14	6.427	1.096	11.50	9.48
NY	Corning Natural Gas Corp.	Gas	11-G-0280, 325 PUR4th 126	7/15/15	10/19/15	4/30/16	3.0	0.426 ¹⁵	9.50	9.00
NY	New York State Electric & Gas Corp.	Electric	15-E-0283	5/20/15	6/15/16	12/31/14	123.8	89.8 ¹⁶	10.00	9.00
NY	New York State Electric & Gas Corp.	Gas	15-G-0284	5/20/15	6/15/16	12/31/14	36.9	41.8 ¹⁶	10.00	9.00
NY	Orange & Rockland Utilities Inc.	Electric	14-E-0493	11/14/14	10/16/15	6/30/14	33.4	18.0 ¹⁷	9.60 ¹⁶	9.00
NY	Orange & Rockland Utilities Inc.	Gas	14-G-0494	11/14/14	10/16/15	6/30/14	40.7	38.6 ¹⁶	10.40	9.00
NY	Rochester Gas & Electric Corp.	Electric	15-E-0285	5/20/15	6/15/16	12/31/14	42.5	50.5	10.00	9.00
NY	Rochester Gas & Electric Corp.	Gas	15-G-0286	5/20/15	6/15/16	12/31/14	22.2	26.0 ¹⁶	10.00	9.00
NY	St. Lawrence Gas Co., Inc.	Gas	15-G-0382	6/29/15	7/15/16	12/31/14	1.23	1.23	--	9.00
ND	Montana-Dakota Utilities Co.	Gas	PU-15-90, 325 PUR4th 440	2/6/15	11/4/15	12/31/15	4.3	2.56	9.75	9.50
OK	Arkansas Oklahoma Gas Corp.	Gas	PUD 201500425	11/13/15	3/30/16	8/31/15	0.446 ¹⁸	0.446 ¹⁸	10.50	10.50
OK	CenterPoint Energy Oklahoma Gas	Gas	PUD 201500118	3/13/15	11/4/15	12/31/14	0.858 ¹⁸	0.858 ¹⁸	10.50	10.50
OK	Oklahoma Natural Gas	Gas	201500213	7/8/15	1/6/16	3/31/15	50.4	29.995	10.50	9.50
OR	Avista Utilities	Gas	UG-288, 329 PUR4th 85	5/1/15	3/15/16	12/31/16	8.56	4.46	9.50	9.40
OR	Cascade Natural Gas Corp.	Gas	UG-287	3/31/15	12/28/15	12/31/16	3.63	0.59	10.10	9.55
OR	Portland General Electric	Electric	UE-294	2/12/15	11/3/15	12/31/16	66	17.8	9.68	9.60
PA	Columbia Gas of Pennsylvania	Gas	2015-2468056	3/19/15	12/3/15	12/31/16	46.2	28.0	N/A	*
PA	PECO Energy Co.	Electric	R-2015-2468981	3/27/15	12/17/15	12/31/16	190.1	127.0	*	*
PA	PPL Electric Utilities	Electric	R-2015-2469275	3/31/15	11/19/15	12/31/16	167.5	124	10.40	*
SD	Montana-Dakota Utilities Co.	Electric	EL15-024	6/30/15	6/15/16	12/31/14	2.7	1.4	--	*
SD	Montana-Dakota Utilities Co.	Gas	NG15-005	6/30/15	6/15/16	12/31/14	1.5	1.2	*	*

Source: Fortnightly research, Phillip S. Cross

components of the technical testimony before it, it instead hit all the points raised by the parties in one fell swoop.

“While the administrative law judge provided an excellent analysis of this issue, the current return on equity will best achieve the goals of

providing appropriate compensation for risk, ensuring the financial soundness of the business, and maintaining a strong ability to attract capital.”

In other words, the commission had bought into the company’s fail-safe position of 10.3 percent.

It would now justify that position on the grounds that an improving economy would likely raise expectations for the average investor.

“Consumers [Power] has planned an ambitious capital investment program, much of which is related to

FIG. 1

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SD	NorthWestern Energy Corp.	Electric	EL14-106	12/19/14	11/4/15	9/30/14	26.5	20.9	--	*
TX	El Paso Electric Co.	Electric	44941	8/10/15	8/25/16	3/31/15	71.48	40.7	10.125	9.70 ¹⁹
TX	Southwestern Public Service Co.	Electric	43695, 328 PUR4th 1	12/8/14	2/23/16 ²⁰	6/30/14	42.07	(4.0) ²¹	10.00	9.70
TX	Texas Gas Service (Gulf Coast Service Area)	Gas	10488	12/30/15	5/3/16	12/31/15	3.17	2.3 ³	--	9.50
VA	Kentucky Utilities Co./Old Dominion Power Co.	Electric	PUE-2015-00063	6/30/15	2/2/16	12/31/14	7.2	5.5	*	* ²²
VA	Virginia Electric Power Co.	Electric	PUE-2015-00027 ⁻²³	3/31/15	11/23/15	--	--	²³	10.00	10.00
WA	Avista Utilities	Electric	UE-150204, 327 PUR4th 269	2/9/15	1/6/16	9/30/14	33.2	(8.1)	10.20	9.50
WA	Avista Utilities	Gas	UG-150205, 327 PUR4th 269	2/9/15	1/6/16	9/30/14	12	10.8	10.20	9.50
WA	Cascade Natural Gas Corp.	Gas	UG-152286	12/1/15	7/7/16	--	10.5	4.0	--	*
WA	Pacific Power & Light Co.	Electric	UE-152253	11/25/15	9/1/16	--	20.3	11.08 ²⁴	9.50	9.50
WV	Mountaineer Gas Co.	Gas	15-0003-G-42T, 325 PUR4th 313	1/5/15	10/13/15	9/30/14	12.2	7.7	9.90	9.75
WI	Northern States Power Co.	Electric	4220-UR-121	5/29/15	12/23/15	12/31/16	27.4	7.6	10.20	10.00
WI	Northern States Power Co.	Gas	4220-UR-121	5/29/15	12/23/15	12/31/16	5.9	4.2	10.20	10.00
WI	Wisconsin Public Service Corp.	Electric	6690-UR-124	4/17/15	12/17/15	12/31/16	96.9	(7.9)	10.20	10.00
WI	Wisconsin Public Service Corp.	Gas	6690-UR-124	4/17/15	12/17/15	12/31/16	9.1	(6.2)	10.20	10.00
WY	Rocky Mountain Power	Electric	20000-469-ER-15	3/2/15	12/30/15	12/31/16	32.40	16.04	9.50	9.50

Source: Fortnightly research, Phillip S. Cross

N/A Not available.

*Settlement agreement, ROE not specified.

1. Gross revenue increase requested.
2. Authorized non-fuel revenue increase.
3. Per approved settlement agreement.
4. Figure approved by order dated 9/30/11.
5. Formula rate adjustment proceeding.
6. Figure shows ROE established in utility's last base rate case in 1995.
7. Date of decision on rehearing of Order No. 87591 in this docket. The original order of 6/3/16 (330 PUR4th 30) had allowed an increase of \$41.76 million in electric rates and \$47.77 million in gas rates.
8. Approved settlement agreement provides for early implementation of \$32.8 million increase effective 11/1/15. An additional increase of \$3.6 million to go into effect 11/1/16 contingent upon filing and approval of supporting documentation.
9. As set forth in a 2005 settlement agreement.
10. Figures represent utility's overall revenue requirement as opposed to a base rate increase.
11. Increase to be phased in over a two-year period per settlement agreement; \$3 million effective 4/1/16 and an additional increase of \$4.4 million effective 4/1/17.
12. ROE not stated in settlement agreement, but the commission finds an ROE in the range of 9.0%-9.5% is supported by the evidence presented in the case.
13. Utility requested an increase of \$7.4 million for 2016 and \$17.1 million for 2017, for a total of \$24.5 million. Utility was granted an increase of \$3.4 million for 2016 and \$8 million for 2017, for a two-year total of \$11.4 million.
14. Per approved settlement agreement. Figure shown is inclusive of major storm event costs.
15. Order approving settlement agreement calling for extension of existing three-year rate plan ending 4/30/15. Plan extended through 4/30/17; base rates remain unchanged from the 2012 rate plan.
16. All figures set forth in a settlement agreement governing a new three-year rate plan.
17. Stipulation results in new two-year rate plan for final year of previous three-year rate plan.
18. Request and increase authorized were in accordance with a performance-based rate-making plan under which the company was deemed entitled to relief if it could show earnings had fallen below a threshold ROE of 10.0%.
19. ROE of 9.70% was approved in settlement for purposes of AFUDC only.
20. Order on rehearing.
21. Figure shown reflects commission finding that utility rate base revenue requirement of \$509.3 million decreased by \$4.0 million from present authorized amount.
22. ROE range of 9.5% to 10.5% is used for annual informational filings.
23. 2013 – 2014 biennial earnings review. Commission orders credit of \$19.7 million to ratepayers under earnings sharing mechanism, with company retaining \$112.4 million.
24. Multi-year rate filing. Rate increase of \$4.4 million effective 9/15/2016. Phase 2 increase of \$6.6 million to begin 9/15/2017.

HOW THE SURVEY WAS CONDUCTED

As in prior years, this year's survey covers cost of equity capital determinations by state public utility commissions during the period September 1, 2015 through September 1, 2016.

The survey methodology remains similar to past years. Requests for information on the results of recent rate proceedings were sent to both regulators and utility financial officials. In addition, direct examination of the commission rate orders, when available, provides additional information.

The traditional cost-of-service rate case remains as the most

obvious source of information on how utility regulators view the issue of shareholder earnings requirements.

Nevertheless, performance-based rate plans, periodic earnings reviews, and special proceedings to determine revenue requirements for restructured electric delivery-only utility operations also contain findings about the appropriate return on equity for utilities and are reported herein.

Explanatory notes accompany most entries, and citations are provided for orders published in Public Utilities Reports, Fourth Series. **—PC**

environmental and generation expenditures that are unavoidable and are saddled with time requirements. 10.3 percent is the upper point for the staff's recommended return on equity range.

Consumers showed, using the staff's exhibit, that the average return on equity resulting from recently decided cases in Michigan, Indiana, Ohio, Pennsylvania, and Wisconsin was 10.26 percent. The commission acknowledges that nationally, [rates] have shown a steady decline (as they have in Michigan), and agrees with the Attorney General that Michigan's economy has stabilized. But [the commission] finds that under present circumstances, it is reasonable to assume that investor expectations may be rising."

See Consumers Energy Co., Case No. U-17735, Nov. 19, 2015, reported

at 325 PUR4th 218.

Not only did the commission allow the utility to keep its 10.3 percent return on equity, but it also addressed the wide range of testi-

and the administrative law judge was much better supported. And that actual evidentiary support for a higher rate was almost nonexistent, except for the testimony presented

The traditional cost-of-service rate case remains as the most obvious source of information on how utility regulators view the issue of shareholder earnings requirements.

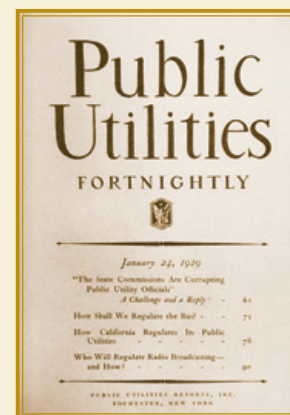
mony in a conclusive fashion, rather than point by point. This view is reflected in a separate dissenting opinion from Commissioner Talberg.

In her dissenting opinion, Talberg said that a 10.0 percent figure recommended by commission staff

by Consumers Energy itself. Talberg expressed the broader view that the commission should better substantiate its determination with the most influential evidence available, rather than rely on a fleeting reference that is not supported by the record. **PUF**

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