SASKATCHEWAN INDUSTRIAL ENERGY CONSUMERS ASSOCIATION

October 30, 2017

To: Mr. Albert Johnston
Chair, Saskatchewan Rate Review Panel
(feedback@saskratereview.ca)
(chair@saskratereview.ca)

Re: SIECA Final Submission Regarding the SaskPower 2018 Rate Application

Dear Mr. Johnston:

Thank you once again for the opportunity to participate in the Saskatchewan Rate Review process regarding the SaskPower 2018 Rate Application. As we have previously stated, the Saskatchewan Industrial Energy Consumers Association (SIECA) collectively represents in excess of 21% of SaskPower's energy sales and 25% of SaskPower's peak demand levels. We therefore have a substantial vested interest in assuring that any rate increase is necessary, and if so, is calculated correctly and impartially, as well as applied fairly to the respective rate payers.

To help SIECA in determining this, the organization employed the services of an independent utility rate and Regulatory Services expert, Kinect Energy, to verify the necessity of SaskPower's proposed 5.1% rate increase request. Despite SaskPower's refusal to provide a response to several interrogatories, our expert was able to develop a limited working cost of service model to test and evaluate various alternatives to SaskPower's cost of service and cost allocation methodologies. Kinect's final report is attached for your reference, detailing the analysis of SaskPower's application, along with several recommendations to the Saskatchewan Rate Review Panel.

In summary, our Regulatory Services expert determined that SaskPower is once again unduly allocating costs to the high load factor customers in the Power Class, while subsidizing the lower load factor customers, by failing to offer rate rebalancing. SIECA has previously voiced its opposition to the generation fixed cost allocation methodology employed by SaskPower, in addition to objecting to the revenue vs. revenue requirement metric used to determine the propriety of its cost allocation, and those objections remain in this rate application. Again, please refer to the attached report for detailed analysis of our findings.

Recommendations to the SRRP

The SRRP should:

1. Deny SaskPower's request for a rate increase.
2. Require SaskPower to provide evidence of its true weighted average cost of capital in all future rate applications.
3. Require SaskPower to calculate any proposed ROR in the commonly accepted format supported by sufficient evidence in all future rate applications.

4. Require SaskPower to provide an account level comparison of its latest actual 12 month OM&A expenses with those in its proposed cost of service and provide evidence supporting any difference between the two in all future rate applications.
5. Require SaskPower to provide a third party depreciation study with its next rate application.
6. Require SaskPower to develop a confidentiality agreement to facilitate its ability to provide confidential data in response to interrogatories.

Thank you for allowing SIECA to submit comments and recommendations to the SRRP for consideration. We look forward to hearing of your conclusions and final recommendation to the Government of Saskatchewan. Any questions regarding this submission should be directed to Eugene Setka, SIECA Chair at (403) 861.7891 – email esetka@francefin.com and James Wirth, SIECA Vice Chair, at (306) 385.7984 – email james.wirth@ks-potashcanada.com.

Submitted on behalf of SIECA members.

Respectfully,

James W.

James Wirth
SIECA Vice Chair

Kinect Energy – Regulatory Services

Review, Analysis and Recommendations Regarding SaskPower's 2018 Rate Application

On Behalf of Saskatchewan Industrial Energy Consumers Association

SaskPower filed its 2018 Rate Application on August 15, 2017 proposing new, increased electric rates beginning March 1, 2018. The proposed rates are a 5.1% increase over current rates. At SIECA's request, Kinect Energy's Regulatory Services evaluated SaskPower's application and provided a memo containing the results (September 6, 2017 memo). SIECA accepted Kinect's proposal for a more detailed study. What follows is the result of Kinect's efforts in that regard.

Kinect Analysis

In its study, Kinect reviewed and analyzed the following SaskPower documents:

1. 2018 Rate Application
2. 2018 Fiscal Test Embedded Cost of Service Study (ECSS)
3. 2016-2017 Annual Report
4. 2017-2018 Q1 Report
5. 2017 (Fiscal) Q1 Load Forecast
6. 2018 Mid-Application Update
7. Various material from SaskPower's 2016-2017 Rate Application including:
    a. SaskPower's application
    b. Review of SaskPower's Application by the Saskatchewan Rate Review Panel's consultant
    c. Saskatchewan Rate Review Panel's (SRRP) Final Report

In addition, Kinect prepared and submitted interrogatories and reviewed SaskPower's response to SRRP interrogatories.

Kinect developed a limited working cost of service model which allowed us to test and evaluate various alternatives to SaskPower's cost of service and cost allocation methodologies.

Kinect's analysis was limited by SaskPower's refusal to provide a response to several interrogatories. SaskPower claimed the subject matter requested was confidential and refused SIECA's proposal to view the requested information under the provisions of a confidentiality agreement.

Conclusions

SaskPower's proposed 5.1% across-the-board rate increase is primarily driven by its desire to achieve a corporate 8.5% return on equity (ROE).

SaskPower's calculation of the return on rate base necessary to produce an 8.5% ROE is not consistent with accepted rate making methodology. It significantly understates the ROE SaskPower is earning on its equity invested in regulated assets, or conversely, overstates the rate of return (ROR) applied to rate base in order to recover SaskPower's cost of equity invested in facilities to serve its customers.

The properly calculated cost of equity underlying SaskPower's 7.15% proposed ROR is significantly greater than 8.5%, and more than the cost of equity granted to investor-owned utilities in the United States. An appropriate calculation of the ROR to achieve SaskPower's stated 8.5% target ROE results in a cost of service lower than revenue at current rates and obviates the need for a rate decrease.

SaskPower continues to utilize cost allocation methodologies criticized by SIECA in its response to the 2017 Rate Application and the 2017 Cost of Service Study.

Cost of Service Based Rate-Making

Cost of service based rate-making starts with the utility's estimated cost to serve its customers. The utility's estimate is usually based on its latest actual expense and plant balance data, adjusted for known and measurable changes. The estimated cost of service includes the utility's operating expenses as well as a return of (through a depreciation expense) and return on (through a calculated return on rate base) its investment in the facilities necessary to serve its customers.

The cost of service estimate is then reduced by any non-rate revenue to determine the total customer revenue requirement. This revenue requirement is then assigned to the various customer classes, either directly or based on an allocation methodology, and subsequently divided by customer class-specific billing determinants to calculate customer rates.

SaskPower's Estimated Revenue Requirement

SaskPower's requested rate increase is based on a $2,539.4 million estimated revenue requirement. The attached Exhibit 1 presents a comparison of SaskPower's estimated revenue requirement components with the corresponding actual cost in the most recent fiscal year (2016-17).

The analysis highlights the following component results:

> **Return on Rate Base** – The significant increase in SaskPower's proposed return on rate base (45.45%) is the driving component of SaskPower's estimated revenue requirement increase. Absent the $210.1 million estimated increase in the return component, SaskPower's projected 2018-19 revenue requirement is essentially the same incurred in 2016-17.
>
> Given the approximate 4% reduction in the rate base upon which the return amount is calculated, it is reasonable to assume that the entire increase in return is the result of SaskPower's return on rate base percentage. As discussed in more detail below, SaskPower's percentage return rate is inappropriate.
>
> **Depreciation Expense** – SaskPower estimates its depreciation expense will increase by 15.43%. SaskPower's application provides almost no data on which to judge the propriety of its depreciation rates. There has not been a third-party depreciation study conducted in seven years. Third party depreciation studies are routinely submitted by utilities in the United States with each rate request filing. SaskPower provides a narrative explanation of its depreciation expense in response to SRRP's interrogatories Q19, Q20 and Q21. These responses do not provide enough information to evaluate the propriety of its estimated 15% increase.
>
> **Operating, Maintenance and Administrative (OM&A) Expense** – SaskPower's estimated OM&A expense increase (2.12%) is the only other revenue requirement component estimated to increase above 2016-17 actual cost. SaskPower's application does not provide sufficient detail to evaluate the direction or magnitude of individual operation and maintenance expense accounts. Various SRRP interrogatories indicate an effort to evaluate the propriety of SaskPower's estimated OM&A expenses at the account level. Given the relatively small estimated OM&A increase, a more detailed evaluation of SaskPower's estimated OM&A expense by Kinect is redundant and inefficient.

SaskPower estimates all other revenue requirement components will be lower than the 2016-17 actual expense.

SaskPower's Return on Rate Base Percentage

SaskPower's proposed ROR of 7.15% is not supported by evidence nor is it calculated according to commonly accepted cost of service based rate making principles. SaskPower appears to develop its proposed 7.15% ROR by determining the percentage return necessary to achieve a target 8.5% corporate return on equity.

However, nowhere in the accepted methodology of determining cost of service based rates is the utility's corporate return on equity goal considered a factor in determining an appropriate ROR. The only relevant consideration of equity in cost of service based rate-making is the cost of the utility's equity component included in funding the rate base necessary to serve its customers. The equity component along with the debt component are included in a weighted average calculation which will produce the ROR, which applied to the utility's rate base will insure that the utility's cost to fund its rate base investment is recovered in rates.

As stated in the National Association of Regulatory Utility Commissioners (NARUC) Electric Utility Cost Allocation Manual:

> *"A fair rate of return is one that will allow the utility to recover its costs of all classes of capital used to finance its rate base. These classes of capital are generally debt and stockholder common equity. The embedded costs of long-term debt and preferred stock are fixed and can be readily computed. The cost of a utility's common equity is reflected in the price that investors are willing to pay for the company's stock and that cost has to be estimated.* "(NARUC Electric Utility Cost Allocation Manual, page 29)
>
> "A utility is allowed the opportunity to earn a reasonable return on its investment that is prudent and dedicated to the public service. The return dollars a utility is entitled to collect is determined by multiplying the rate base by the rate of return". (NARUC Electric Utility Cost Allocation Manual, page 30)

Stated differently, a utility is allowed the opportunity to recover its cost of debt and equity needed to fund its investment in facilities to serve its customers. It is not entitled to a return on its corporate equity.

The allowed rate of return applied to rate base is the weighted average cost of debt and equity determined by each individual component cost and the ratio of each in the utility's capital structure.

An example of the commonly accepted methodology is shown below.

Table 1

		Amount	Capital Structure %		Cost of Capital		Component Weighted Cost of Capital
Debt	$	75,000	75.00%	*	8%	=	6.00%
Equity	$	25,000	25.00%	*	10%	=	2.50%
	$	100,000	100.00%		Return on Rate Base =		8.50%

The cost of debt capital is usually based on the utility's long term debt interest expense. The cost of equity is usually based on a detailed study of the return necessary to attract capital in the equity market. Three commonly used study methodologies are the Discounted Cash Flow Model (DCF), the Capital Asset Pricing Model (CAPM), and the Risk Premium Model (RPM).

SaskPower does not provide a study using any of these methods as evidence of its cost to attract equity capital. The only basis provided by SaskPower for its "cost" of equity is its stated desire for an 8.5% corporate return on equity.

Assuming the 8.5% is a reasonable approximation for SaskPower's cost of equity, using the cost of debt and capital structure information provided in SaskPower's response to various SRRP interrogatories will produce the calculated return on rate base shown below.

Table 2

Calculated Return on Rate Base at SaskPower's Stated 8.5% ROE

		Amount $ Million	Capital Structure %		Cost of Capital		Component Weighted Cost of Capital
Long Term Debt	$	6,994	75.16%	*	4.87%	=	3.66%
Equity	$	2,312	24.84%	*	8.50%	=	2.11%
	$	9,306	100.00%		Return on Rate Base =		5.77%

See attached Exhibit 2 for details

The 5.77% return on rate base calculated above is significantly lower than the 7.15% used by SaskPower in its ECCS to determine its proposed 5.1% rate increase. As demonstrated later, adjusting SaskPower's cost of service calculation to reflect this lower return on rate base eliminates the need for the proposed 5.1% increase.

Correspondingly, starting with SaskPower's proposed 7.15% return on rate base and solving for the underlying equity cost reveals the true cost of equity imbedded in SaskPower's proposed rates as shown in the table below.

Table 3

Calculated True ROE at SaskPower's Stated Return on Rate Base							
		Amount $ Million	Capital Structure %		Cost of Capital		Component Weighted Cost of Capital
Long Term Debt	$	6,994	75.16%	*	4.87%	=	3.66%
Equity	$	2,312	24.84%	*	14.05%	=	3.49%
	$	9,306	100.00%		Return on Rate Base =		7.15%
	See attached Exhibit 2 for details						

Allowing SaskPower to earn a 14.05% return on its equity invested in rate base is well out of line with the cost of equity approved for electric utilities in the United States. According to the most recent annual survey conducted by PUR Utility Regulatory News, approved investor owned utility ROEs averaged 9.62% (see attached Exhibit 3 for a summary of results and Attachment A for the actual report).

It is worth noting that the report results are for investor owned utilities which arguably have a higher risk and tax exposure and therefore higher ROE than municipally financed utilities.

Corrected Revenue Requirement

Assuming 8.5% is an accurate representation of SaskPower's cost of equity, the resulting 5.77% ROR to SaskPower's estimated rate base reduces SaskPower revenue requirement by $129.7 million and as the table below shows, eliminates the need for SaskPower's proposed 5.1% rate increase.

Table 4

Revenue Requirement Calculation $ Million				
		SaskPower Proposed		SIECA Revised
Revenue Requirement	$	2,539.4	$	2,409.5
Revenue at Current Rates		2,418.5		2,418.5
Revenue Shortfall	$	120.9	$	(9.0)
Shortfall as % of Current Rates		5.0%		-0.4%
See attached Exhibit 4 for details				

Exhibit 5 compares the rates developed from the SIECA revised revenue requirement with the current and those proposed by SaskPower.

Cost Allocation and Rate Design

SaskPower provides an ECSS to support its proposed $2,539.4 million revenue requirement and its allocation to customer classes.

In determining customer class cost responsibility, SaskPower uses the same methodology it used in its 2017 rate application. SaskPower has not changed its allocation methodology in this case to adopt recommendations resulting from the 2017 Elenchus Review of SaskPower's Cost Allocation and Rate Design Methodologies.

SIECA has previously voiced its opposition to the "2CP" generation fixed cost allocation methodology and SaskPower's use of an opaque Equivalent Peaker generation fixed cost classification methodology unsupported by evidence. Both of these allocation issues are present again in the current application.

By proposing an across the board 5.1% rate increase to all customer classes, SaskPower is effectively continuing the relative customer class cost responsibility determined some time ago in SaskPower's last rate rebalancing study. Despite the SRRP's recommendation in the 2016 rate application, SaskPower has not offered a new rate rebalancing in this application. SaskPower relies on its revenue/revenue requirement ratio metric to demonstrate the propriety of continuing its previous rate design.

Here again SIECA has registered its opposition to the revenue vs. revenue requirement metric to determine the propriety of its cost allocation in its response to both the previous rate application and the 2017 Elenchus report. The 1.03 Power Class ratio calculated in SaskPower's current ECCS is yet more evidence of the bias in SaskPower's methodology which under allocates cost to low load factor customers at the expense of high load factor customers.

Recommendation to the SRRP

The SRRP should:

1. Deny SaskPower's request for a rate increase.
2. Require SaskPower to provide evidence of its true weighted average cost of capital in all future rate applications.
3. Require SaskPower to calculate any proposed ROR in the commonly accepted format supported by sufficient evidence in all future rate applications.
4. Require SaskPower to provide an account level comparison of its latest actual 12 month OM&A expenses with those in its proposed cost of service and provide evidence supporting any difference between the two in all future rate applications.
5. Require SaskPower to provide a third party depreciation study with its next rate application.
6. Require SaskPower to develop a confidentiality agreement to facilitate its ability to provide confidential data in response to interrogatories.

SaskPower 2018 Rate Case
Cost of Serivce Comparison ($ Million)

Line No.	Particulars	SasksPower 2016-2017		SaskPower, Filed Case		Increase (Decrease) $	Increase (Decrease) %
	(a)	(b)		(c)		(d)	(e)
	Rate Base						
1	Plant in Service	$ 15,050.0	/1	$ 15,372.0	/4	$ 322.0	2.1%
2	Accumulated Depreciation	(5,532.0)	/1	(6,283.8)	/4	(751.8)	13.6%
3	Net Plant	$ 9,518.0		$ 9,088.2		$ (429.8)	-4.52%
4	Working Capital, Inventories, Other	310.9	/2	310.9	/4	-	0.0%
5	Total Rate Base	$ 9,828.9		$ 9,399.1		$ (429.8)	-4.4%
	Expense						
6	Fuel & Purchase Power	661.4	/3	649.3	/4	(12.1)	-1.83%
7	O,M & A	674.8	/3	689.1	/4	14.3	2.12%
8	Depreciation	493.8	/3	570	/4	76.2	15.43%
9	Taxes & Other	110.2	/3	72.5	/4	(37.7)	-34.21%
10	Return on Rate Base	462.3	/3	672.4	/4	210.1	45.45%
11	Total Cost of Service	$ 2,402.5		$ 2,653.3		$ 250.8	10.44%
12	less Other Revenue	(125.8)	/3	(113.9)	/4	11.9	-9.46%
13	Total Revenue Requirement	$ 2,276.7		$ 2,539.4		$ 210.1	9.23%

/1 Source: SaskPower Response to SRRP Q4
/2 Estimated
/3 Source: SaskPower 2018 Rate Application -Consolidated Statement of Income, page 26
/4 Source: SaskPower 2018 Fiscal Embedded Cost of Service Study, Schedule 1

SaskPower 2018 Rate Case
Rate of Return Calculation 2018-2019 ($ Millions)

Calculated True ROE at SaskPower's Stated Return on Rate Base

Ln. No.	Particulars	$	Structure	Cost	Return
	(a)	(b)	(c)	(d)	(e)
1	Long Term Debt	6,994 /1	75.2%	4.87% /3	3.66%
2	Equity	2,312 /2	24.8%	14.05%	3.49%
3		9,306	100%		7.15% /4

Calculated Return on Rate Base at SaskPower's Stated 8.5% ROE

Ln. No.	Particulars	$	Structure	Cost	Return
	(a)	(b)	(c)	(d)	(e)
4	Long Term Debt	6,994 /1	75.2%	4.87% /3	3.66%
5	Equity	2,312 /2	24.8%	8.50% /5	2.11%
6		9,306	100%		5.77% /4

/1 SRRP Q10, 2017/18 Gross long-term debt and Finance lease obligations
/2 SRRP Q10, 2017/18 Average Equity
/3 Weighted Cost of Long-term Debt as calculated on SRRP Q13
/4 SaskPower's Rate of Return from 2018 Fiscal Embedded Cost of Service Study Schedule 1.0
/5 SaskPower's target rate of return on equity as presented in section 4.3 of the 2018 Rate Application

SaskPower 2018 Rate Case
PUR Annual Study of Electric Utilities
Authorized Rate of Return on Common Equity

Ln. No.	Company	Service	State/ Province	Approved Rate
	(a)	(b)	(c)	(e)
1	UNS Electric, Inc.	Electric	AZ	9.50%
2	Entergy Arkansas	Electric	AR	9.75%
3	Avista Corp.	Electric	ID	9.50%
4	Ameren Illinois	Electric	IL	9.14%
5	Commonwealth Edison Co.	Electric	IL	9.14%
6	Indianapolis Power & Light Co.	Electric	IN	9.85%
7	Northern Indiana Public Service Co.	Electric	IN	9.98%
8	Kansas City Power & Light Co.	Electric	KS	9.30%
9	Cleco Power LLC	Electric	LA	10.90%
10	Baltimore Gas & Electric Co.	Electric	MD	9.75%
11	Fitchburg Gas & Electric Light Co.	Electric	MA	9.80%
12	Consumers Energy	Electric	MI	10.30%
13	DTE Electric Co.	Electric	MI	10.30%
14	Upper Peninsula Power Co.	Electric	MI	10.00%
15	Mississippi Power Co.	Electric	MS	9.23%
16	The Empire District Electric Co.	Electric	MO	9.90%
17	Kansas City Power & Light Co.	Electric	MO	9.50%
18	Montana-Dakota Utilities Co.	Electric	MT	9.50%
19	Newfoundland Power Inc.	Electric	NL	8.50%
20	Atlantic City Electric Co.	Electric	NJ	9.75%
21	El Paso Electric Co.	Electric	NM	9.48%
22	New York State Electric & Gas Corp.	Electric	NY	9.00%
23	Orange & Rockland Utilities Inc.	Electric	NY	9.00%
24	Rochester Gas & Electric Corp.	Electric	NY	9.00%
25	Portland General Electric	Electric	OR	9.60%
26	El Paso Electric Co.	Electric	TX	9.70%
27	Southwestern Public Service Co.	Electric	TX	9.70%
28	Virginia Electric Power Co.	Electric	VA	10.00%
29	Avista Utilities	Electric	WA	9.50%
30	Pacific Power & Light Co.	Electric	WA	9.50%
31	Northern States Power Co.	Electric	WI	10.00%
32	Wisconsin Public Service Corp.	Electric	WI	10.00%
33	Rocky Mountain Power	Electric	WY	9.50%
34	Average			9.62%

Source: PUR *Utility Regulatory News* , December 30, 2016

SaskPower 2018 Rate Case
Cost of Service Comparison ($ Million)

Line No.	Particulars	SaskPower, Filed Case	SIECA Adjustments	Filed Case, as Adjusted
	(a)	(b)	(c)	(d)
	Rate Base			
1	Plant in Service	$ 15,372.0	-	$ 15,372.0
2	Accumulated Depreciation	(6,283.8)	-	(6,283.8)
3	Net Plant	$ 9,088.2	-	$ 9,088.2
4	Working Capital, Inventories, Other	310.9	-	310.9
5	Total Rate Base	$ 9,399.1	-	$ 9,399.1
	Expense			
6	Fuel & Purchase Power	649.3	-	649.3
7	O,M & A	689.1	-	689.1
8	Depreciation	570	-	570.0
9	Taxes & Other	72.5	-	72.5
10	Return on Rate Base	672.4	(129.9)	542.5
11	Total Cost of Service	$ 2,653.3	$ (129.9)	$ 2,523.4
12	less Other Revenue	(113.9)	-	(113.9)
13	Total Revenue Requirement	$ 2,539.4	$ (129.9)	$ 2,409.5
14	Revenue at Current Rates	2,418.5		2,418.5
15	Required Rate Revenue Increase (Decrease)	$ 120.90		$ (9.00)
16	Percentage Rate Increase or Decrease	5.0%		-0.4%
17	Rate of Return on Rate Base	7.15%		5.77%

SaskPower 2018 Rate Case
Rate Proposal Comparison

POWER - STANDARD

Line No.	RATE CODE	DESCRIPTION	BASIC ($/month)	Energy Balance Rate	Demand Balance Rate ($/kVA)
	(a)	(b)	(c)	(d)	(e)
1	E22 Existing	25kV - Customer Owned Transformation	5,976.74	6.665	10.532
2	E22 Sask Proposed		6,280.32	7.004	11.067
3	E22 Kinect Proposed		5,954.53	6.640	10.493
4	E23 Existing	72kV - Customer Owned Transformation	6,850.77	6.014	8.117
5	E23 Sask Proposed		7,198.75	6.319	8.529
6	E23 Kinect Proposed		6,825.31	5.992	8.087
7	E24 Existing	138kV - Customer Owned Transformation	7,354.73	5.900	8.000
8	E24 Sask Proposed		7,728.31	6.200	8.406
9	E24 Kinect Proposed		7,327.40	5.878	7.970
10	E25 Existing	230kV - Customer Owned Transformation	7,707.38	5.900	8.000
11	E25 Sask Proposed		8,098.87	6.200	8.406
12	E25 Kinect Proposed		7,678.74	5.878	7.970

POWER - TIME OF USE

Line No.	RATE CODE	DESCRIPTION	BASIC ($/month)	On-Peak Energy Rate	Off-Peak Energy Rate	Demand Balance Rate ($/kVA)
	(a)	(b)	(c)	(d)	(e)	(f)
13	E82 Existing	25kV - Customer Owned Transformation	5,976.74	7.238	6.238	10.532
14	E82 Sask Proposed		6,280.32	7.577	6.577	11.067
15	E82 Kinect Proposed		5,954.53	7.211	6.215	10.493
16	E83 Existing	72kV - Customer Owned Transformation	6,850.77	6.587	5.587	8.117
17	E83 Sask Proposed		7,198.75	6.892	5.892	8.529
18	E83 Kinect Proposed		6,825.31	6.563	5.566	8.087
19	E84 Existing	138kV - Customer Owned Transformation	7,354.73	6.473	5.473	8.000
20	E84 Sask Proposed		7,728.31	6.773	5.773	8.406
21	E84 Kinect Proposed		7,327.40	6.449	5.453	7.970
22	E85 Existing	230kV - Customer Owned Transformation	7,707.38	6.473	5.473	8.000
23	E85 Sask Proposed		8,098.87	6.773	5.773	8.406
24	E85 Kinect Proposed		7,678.74	6.449	5.453	7.970

PUR

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UTILITY REGULATORY NEWS

PUBLIC UTILITIES REPORTS, INC. LETTER # 4300 DECEMBER 30, 2016

THE UTILITY REPORTER SPECIALIZING IN STATE COMMISSION RULINGS

RETURN ON EQUITY

2016 ROE Survey — Justifying Returns When Evidence is Thin

By Phillip S. Cross

It is often said that rate making is as much art as science. That is particularly true in setting the rate of return on common equity (ROE) portion 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 accompanying table reports several categories of basic data drawn from electric and natural gas base rate decisions issued during the past year, with special emphasis on the ROE component.

Operational and financial figures and statistics represent a crucial starting point in any rate case, but they tell only part of the story. The responsibility for setting a level of ROE that is fair to both shareholders and consumers alike illustrates the "art versus science" dilemma faced by regulators.

One case reported herein provides a prime example of the breadth of issues placed before regulators and of how they assess the entire record to settle on a single ROE figure to use in determining a utility's revenue requirement. That proceeding involved an electric rate case filed by Consumers Energy Company with the Michigan Public Service Commission.

In hearings before the commission, witnesses advocated widely divergent ROEs, ranging from a low of 9.6% to a high of 10.7%. In evaluating the different recommendations, the commission had before it the usual testimony regarding various financial cost models, with each party presenting its own analysis in support of its respective estimate of the ROE required in order for the applicant company to attract an adequate level of capital.

Those ROE cost models included proxy group recommendations, stock market performance data, bond rating data, and Treasury bond yield risk premium analyses, to name a few. However, what was particularly notable was the presentation of a broad range of less-than-objective types of evidence that could bear on an investor's decision on whether to purchase utility stock.

The commission reported that the utility and other stakeholders had exerted considerable effort in developing testimony detailing a wide range of seemingly subjective opinions as to what factors investors themselves think about when deciding where to put their money. For instance, Consumers Energy had proffered technical evidence at the outset to

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PUR Incorporated

RETURN ON EQUITY (Continued from page 1)

support its request for a 10.7% ROE, but it also later in the case advanced a lower "fail-safe" position in response to a proposed ruling by an administrative law judge (ALJ) in which the ALJ had suggested a value no greater than 10.0%.

Pursuant to that fail-safe maneuver, the utility asked the commission to recognize that investors would likely expect the 10.3% figure approved by the commission in the company's most recent rate proceeding in 2012 to remain in effect. The utility argued that while its cost analyses showed that investors should want a higher rate, 10.3% was still the minimum rate that investors would accept, especially given the need for additional revenue to fund the company's unusually ambitious and expensive capital improvement program already under way.

Pointing out that it was currently engaged in a capital investment program pegged at more than $7 billion over the period 2015 to 2019, with implications both for risk and for future capital attraction, Consumers Energy alleged that if the commission were to drop the utility's ROE to 10.00%, as proposed by commission staff and endorsed by the ALJ, it would "send the message to investors that Michigan is a volatile regulatory environment in which investors cannot depend upon consistent or fair regulatory treatment."

The utility argued as well that in order to assure ongoing access to capital at a reasonable cost, it needed to maintain its recently improved credit rating. On that point, though, various consumer groups answered that the improved ratings meant that the company already had access to lower-cost credit in conjunction with an improved cash position. That would imply a lower ROE requirement, they said. As one opposing witness commented, it is an "odd world" where any reduction in a utility's rate of return (or even just a failure to raise the rate) renders the regulatory environment "volatile."

A similar back-and-forth played out on other issues, including claims that the utility actually enjoys reduced risk, given the full set of cost trackers and decoupling measures that form part of the ratemaking process in Michigan and that current historically low interest rates militate toward adjustments to ROE forecasts. Additionally, opponents observed that ROEs awarded by regulators in other jurisdictions have declined over recent years to levels even lower than the 10% figure advanced by commission staff. They further alleged that investors might not yet fully recognize or appreciate the relative economic stability prevailing today both in the U.S. overall and in the state of Michigan.

The commission declined to address each element of the technical testimony before it individually, instead choosing to hit all the points raised by the parties in one fell swoop. It stated, "While the ALJ provided an excellent analysis of this issue, the Commission finds that the current ROE 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%, and had justified adoption of that position on the grounds that an improving economy would likely raise expectations for the average investor, despite there being relatively little evidence to that effect.

In expounding on its decision, the commission alluded to the utility's ambitious capital investment program, much of which it said is related to environmental and generation expenditures that are both unavoidable and saddled with time limits. Moreover, the commission highlighted the fact that the 10.3% value reflected the upper level of commission staff's recommended range of ROE.

The commission also pointed out that, relying on commission staff's own exhibit, Consumers Energy had shown that the average ROE authorized in recently decided cases in Michigan, Indiana, Ohio, Pennsylvania, and Wisconsin was 10.26%. While the commission conceded that ROE rates both nationally and within Michigan have been steadily declining and that the state's economy has largely stabilized, it said that it nevertheless was convinced that under present circumstances, it was reasonable to assume that investor expectations may be rising. *See, Re Consumers Energy Co., Case No. U-17735, Nov. 19, 2015, reported at 325 PUR4th 218.*

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RETURN ON EQUITY (Continued from page 2)

Some might say the commission went a bit too far — not only in allowing the utility to retain its existing 10.3% ROE, but also in addressing the wide range of testimony in such a conclusory fashion, rather than point by point. Indeed, that view was reflected in a separate dissenting opinion written by Commissioner Sally A. Talberg.

In her statement, Commissioner Talberg said that the 10.0% figure recommended by commission staff and advocated by the ALJ was much better supported on the record. In fact, she asserted, actual hard evidence for a higher rate was "almost nonexistent," except for the testimony presented by Consumers Energy itself. The commissioner expressed the broader view that the commission must more fully substantiate its determinations based on the "most influential evidence" available, rather than rely solely on "a fleeting reference that is not otherwise well supported by the record."

ROE Survey Methodology

This year's survey covers cost of equity capital determinations by state public utility commissions during the period September 1, 2015 through August 31, 2016. The way the survey was conducted remains similar to past years – requests for data 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, provided further information. The traditional cost-of-service rate case remains the most obvious source of information on how utility regulators view the issue of shareholder earnings requirements. At the same time, however, performance-based rate plans with earnings-sharing provisions, periodic earnings reviews, and special proceedings to determine revenue requirements for restructured "delivery-only" energy utilities have become more widespread. Such dockets also provide relevant information on appropriate ROEs for utilities and are reported herein. Explanatory notes accompany a number of the entries, and citations are provided for those commission orders published in *Public Utilities Reports, Fourth Series (PUR4th). – PC*

ANNUAL SURVEY OF ELECTRIC AND GAS UTILITIES

AUTHORIZED RATE OF RETURN ON COMMON EQUITY

Company Name	Type of Service (Electric or Gas)	Case, Docket, or Decision No.	Application Date	Order Date	Test-year End Date	Increase (Decrease) Requested ($Million)	Increase (Decrease) Granted ($Million)	Rate of Return on Common Equity: Previously Authorized Rate (%)	Rate of Return on Common Equity: Newly Authorized Rate (%)
ARIZONA									
UNS Electric, Inc.	Electric	75697	5/25/15	8/18/16	12/31/14	22.6[1]	15.1[2]	9.50	9.50
ARKANSAS									
Entergy Arkansas	Electric	15-015-U	4/24/15	2/23/16	3/31/15	268.5	225.1	9.50	9.75
SourceGas Arkansas, Inc.	Gas	15-011-U	4/1/15	1/28/16	3/31/15	12.6	8.0	9.30	9.40
COLORADO									
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
IDAHO									
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
Avista Corp.	Gas	AVU-G-15-01	6/1/15	12/18/15	12/31/14	3.20	2.5	10.50	9.50
ILLINOIS									
Ameren Illinois	Electric	15-0305[5]	4/24/15	12/9/15	12/31/14	109.174	105.78	9.25	9.14
Ameren Illinois	Gas	15-0142	1/23/15	12/9/15	12/31/16	12.62	11.97	9.08	9.60
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
INDIANA									
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
Northern Indiana Public Service Co.	Electric	44688	10/1/15	7/18/16	3/31/15	126.6	72.5	10.20	9.975
KANSAS									
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	*
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
Westar Energy, Inc.	Electric	15-WSEE-115-RTS	3/2/15	9/24/15	9/30/14	250.9	185.3	10.00	*
LOUISIANA									
Cleco Power LLC	Electric	U-33848[5]	10/31/15	8/11/16	6/30/15	N/A	N/A	10.90	10.90
MARYLAND									
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
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
MASSACHUSETTS									
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
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
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
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
MICHIGAN									
Consumers Energy	Electric	U-17735, 325 PUR4th 218	12/5/14	11/19/15	5/30/16	163	126	10.30	10.30
Consumers Energy	Gas	U-17882	7/17/15	4/21/16	12/31/16	85	40	10.30	*

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Company Name	Type of Service (Electric or Gas)	Case, Docket, or Decision No.	Application Date	Order Date	Test-year End Date	Increase (Decrease) Requested ($Million)	Increase (Decrease) Granted ($Million)	Rate of Return on Common Equity	
								Previously Authorized Rate (%)	Newly Authorized Rate (%)
MICHIGAN *(continuation)*									
DTE Electric Co.	Electric	U-17767	12/19/14	12/11/15	6/30/16	370.0	238.2	10.50	10.30
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
Upper Peninsula Power Co.	Electric	U-17895	9/18/15	9/18/16	12/31/16	6.68	4.65	10.15	10.00
MINNESOTA									
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
MISSISSIPPI									
CenterPoint Energy, Inc.	Gas	12-UN-139	5/1/15	12/3/15	12/31/14	2.51	1.91	9.27	9.53
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
MISSOURI									
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
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
MONTANA									
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]
NEWFOUNDLAND									
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
NEW JERSEY									
Atlantic City Electric Co.	Electric	ER106030252	3/22/16	8/24/16	12/31/15	84.4	45.0[14]	9.75	9.75
NEW MEXICO									
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
NEW YORK									
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
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
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
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
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
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
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
St. Lawrence Gas Co., Inc.	Gas	15-G-0382	6/29/15	7/15/16	12/31/14	1.23	1.23	--	9.00
NORTH DAKOTA									
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
OKLAHOMA									
Arkansas Oklahoma Gas Corp.	Gas	PUD 201500425	11/13/15	3/30/16	8/31/15	0.446[15]	0.446[18]	10.50	10.50
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

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								Previously Authorized Rate (%)	Newly Authorized Rate (%)
OKLAHOMA *(continuation)*									
Oklahoma Natural Gas	Gas	201500213	7/8/15	1/6/16	3/31/15	50.4	29.995	10.50	9.50
OREGON									
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
Cascade Natural Gas Corp.	Gas	UG-287	3/31/15	12/28/15	12/31/16	3.63	0.59	10.10	9.55
Portland General Electric	Electric	UE-294	2/12/15	11/3/15	12/31/16	66	17.8	9.68	9.60
PENNSYLVANIA									
Columbia Gas of Pennsylvania	Gas	2015-2468056	3/19/15	12/3/15	12/31/16	46.2	28.0	N/A	*
PECO Energy Co.	Electric	R-2015-2468981	3/27/15	12/17/15	12/31/16	190.1	127.0	*	*
PPL Electric Utilities	Electric	R-2015-2469275	3/31/15	11/19/15	12/31/16	167.5	124	10.40	*
SOUTH DAKOTA									
Montana-Dakota Utilities Co.	Electric	EL15-024	6/30/15	6/15/16	12/31/14	2.7	1.4	—	*
Montana-Dakota Utilities Co.	Gas	NG15-005	6/30/15	6/15/16	12/31/14	1.5	1.2	*	*
NorthWestern Energy Corp.	Electric	EL14-106	12/19/14	11/4/15	9/30/14	26.5	20.9	—	*
TEXAS									
El Paso Electric Co.	Electric	44941	8/10/15	8/25/16	3/31/15	71.48	40.7	10.125	9.70[19]
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
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
VIRGINIA									
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]
Virginia Electric Power Co.	Electric	PUE-2015-00027[23]	3/31/15	11/23/15	—	—	—[23]	10.00	10.00
WASHINGTON									
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
Avista Utilities	Gas	UG-150205, 327 PUR4th 269	2/9/15	1/6/16	9/30/14	12	10.8	10.20	9.50
Cascade Natural Gas Corp.	Gas	UG-152286	12/1/15	7/7/16	—	10.5	4.0	—	*
Pacific Power & Light Co.	Electric	UE-152253	11/25/15	9/1/16	—	20.3	11.08[24]	9.50	9.50
WEST VIRGINIA									
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
WISCONSIN									
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
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
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

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								Previously Authorized Rate (%)	Newly Authorized Rate (%)
WISCONSIN *(continuation)*									
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
WYOMING									
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; Fortnightly.com ROE Survey Database

ENDNOTES

* Settlement agreement; ROE not specified.

NA — Not available

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. Both the revenue requirement and ROE are set forth in a stipulation.
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.